

REVIEW OF REGULATORY ASPECTS OF THE WATER SERVICES SECTOR

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EXECUTIVE SUMMARY

Frequent incidents of non-compliance with potable water quality standards, the discharge of raw sewage into river systems and the deterioration in water supply system assets through operating deficiencies and lack of maintenance, has increasingly brought into focus the question of the regulatory framework for water and sanitation services. The Department of Water Affairs and Forestry has been developing a regulatory strategy based on the premise that the Department would be “the regulator”. The Water Research Commission initiated this research to inform that debate and provide independent research into the topic. The research approach was to:

- Review international theory, practice and models;
- Review the legislative and policy framework in South Africa;
- Pay special attention to “pro-poor” regulation and the potential impact of General Agreement on Trade in Services (GATS);
- Integrate these reviews into possible regulatory models for South Africa;
- Solicit the views of stakeholders;
- Prepare conceptual organisational models and estimate their costs; and
- Draw conclusions.

The purpose of regulation is to ensure that the service providers or operators of water services deliver in accordance with the law and the policy of the government. The literature review shows that there can often be a misalignment between the objectives of the different spheres of government and more starkly so, if the services are provided by a private company.

The purpose of regulation is to ensure that the service providers or operators of water services deliver in accordance with the law and the policy of the government.

In South Africa, the Constitution assigns to local government the executive authority and right to administer the functional area of “*water and sanitation services limited to potable water supply systems and domestic waste-water and sewage disposal systems*”. The legislative competence over this functional area is however vested concurrently in the national and provincial spheres of government. However, Parliament took the initiative and the Water Services Act was promulgated. None of the provinces has used the concurrent competence to enact provincial legislation, nor has any province exercised its authority in terms of the Constitution by implementing

this national legislation (although in reality, given the powers assigned to the Minister, this is impractical). Consequently, the Minister, through the Department of Water Affairs and Forestry, implements the Water Services Act, as well as national policy. The Constitution also places an obligation on national government to take legislative and other measures to support and strengthen the capacity of municipalities to manage their own affairs, to exercise their powers and to perform their functions. Conversely, national government may not impede a municipality's ability or right to exercise its powers or perform its functions. Provincial government has supervision over local government which includes power to intervene in prescribed circumstances.

Regulation, in some form, is the mechanism whereby national government, through this complexity, ensures that local government delivers water and sanitation services in accordance with legislation, regulations, norms, standards, and national policy.

In the draft National Water Services Regulation Strategy, DWAF proposes that the

Department be the "regulator" in a form of extending or focussing the normal default functions of national government. Basically, it proposes creating a central unit for focus while the regional offices will act as the implementing arm. The option of an independent regulator is not considered.

In the international literature and case studies the concept of a "regulator" is more understood as referring to an entity that is separated from the line departments of government

By contrast, this research examined the international literature and case studies where the concept of a "regulator" is more understood as referring to an entity that is separated from the line departments of government. An example of

an independent regulator in South Africa's case is the National Energy Regulator (NERSA).

There seems to be apprehension about what a regulator actually does and the powers that it exercises. However, the reality is that the regulator only applies the law and policy of the government. Regulators generally have no independent policy-making or legislative authority. They simply apply what they have been mandated to do by government. When a regulator exercises its independence, it means that it

takes its decisions based on its mandate in an objective manner and without short-term interference by external agencies. In this sense, its independence is comparable to the courts applying the law. Other typical elements of independence is an own source of income, e.g. from licence fees rather than the budgeting process.

Whether the institutional form is government as regulator or an independent entity as regulator conceptually makes no difference to its objectives or its basic task. The international focus on independent regulators relates largely to effectiveness. The limited survey conducted as part of this research suggests that within South Africa, stakeholders, outside of national government, appear to favour an independent regulator because, it is said, DWAF will be unable to fulfil simultaneously the three roles it defines for itself as regulator, supporter and enabler. This is because at times the roles are potentially conflicting and pose a threat to the transparency and equity that are among the hallmarks of good governance. How, for example, will departmental management react in circumstances where the failure of a municipality to meet effluent standards could be attributed to a failure of the DWAF support function? Moreover, the human and financial resources assigned to regulation within the Department will be subject to budget vagaries and competition from a multitude of other functions the Department must fulfil. The unfavourable side of an independent regulator is the cost and the requirement for skills that are in short supply.

The research found that the legislation, regulations and policy that a regulator would have to apply are already well defined. The research paid particular attention to the question of “pro-poor” regulation. It found that all of the macro-economic and sectoral policy and strategy instruments issued by government since 1994 set as priorities the alleviation of poverty and the extension of services

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Most of the case studies from developing countries had regulators with a pro-poor mandate focussing on services quality and affordability.

to the un-served. Government policy would thus unequivocally support a “pro-poor” regulatory paradigm.

Most of the case studies from developing countries had regulators with a pro-poor mandate focussing on services quality and affordability. The research identified the characteristics that would characterise a pro-poor regulator as:

- General sensitivity to the plight of the poor reinforced by intensive information gathering about their circumstances;
- Strong focus on consumer protection and the promotion by the regulator of special community-level institutions to act as channels for complaints such as in Zambia’s Water Watch Groups and in Mozambique;
- A developmental approach is nurtured;
- Tariff setting that differentiates on the basis of affordability (Cartagena case-study);
- Priority attention to the expansion of services to those not yet served;
- Highly developed mechanisms for public participation;
- Tripartite partnerships between the public, private and civil society sectors;
- Accessible complaint channelling mechanisms;
- Flexibility in the adoption and application of rules and standards particularly in the trade-off between cost and service quality dimensions such as pressure and reliability (but not water quality); and
- Flexibility with or separate systems for informal community level providers.

All of these characteristics can be engendered in a regulator by appropriate attention to the mandate under which it will operate. The NERSA model already provides a basis.

The case studies also indicated the following lessons for South Africa:

- Stakeholder mobilisation is an important part of effective regulation, especially if it is to be pro-poor;
- The financing of a regulator must be sufficient, assured and not subject to political expediency;
- A regulator must be protected from political interference particularly if it is to have a tariff setting function;
- The regulatory function must be separated from policy-making and other government functions;

- A regulator takes time to establish;
- A dispute resolution mechanism such as an ombudsman, tribunal or arbitration body is advantageous;
- The regulatory roles and authority must be clear and unambiguous.

The legislative review found that, subject to expert legal opinion, the setting up of an

independent regulator was already possible under current legislation. However, the mechanism would be somewhat contrived and therefore preferable to pass new legislation, modelled on that for NERSA. The research team did hear murmurings of unconstitutionality but NERSA has operated for several years without challenge.

A regulator can be assigned any number of functions. One source categorises regulatory functions as economic, social, service quality, water quality and health,

consumer protection and environmental. The draft National Water Services Regulation Strategy regards regulation of all of these as necessary. The research found that most international regulators do not embrace the full range but are assigned functions that are a priority to their governments. The Ofwat (England and Wales) case is the extreme example, as it is solely an economic regulator. The Porto Allegre case places most of its focus on consumer protection. The position in South Africa will be complicated by the responsibility of other national and provincial departments for some of the functions.

The approach to regulation and the instruments used to gain compliance vary considerably. Again, Ofwat, as the extreme example, levies fines of millions of pounds on the private companies it regulates for transgressions of the rules. However, most of the regulators in developing countries use less punitive measures such as publicity. In South Africa, the Constitutional imperative of cooperative government backed up by the Inter-governmental

All of the regulators in the case studies have provision for some form of “public”, “citizen” or “community” participation in the regulatory function.

Relations Act, would mean that measures would generally not be punitive.

All of the regulators in the case studies have provision for some form of “public”, “citizen” or “community” participation in the regulatory function. This is most prominent in the developing countries. In Zambia, for example, NWASCO, the national regulator is assisted by volunteer, but formally recognised, “water watch groups” whose functions are mainly to monitor the service providers and to act as the first-line dispute resolution mechanism for consumers. In Cartagena, Columbia, there is a system of 265 statutory *Juntas Administradoras Locales* that represent the citizens at sub-municipal level, and whose function, as part of the regulatory system, is to monitor service providers in all sectors. In South Africa, the law requires government and local government as water service authorities to involve communities in their functions. However, the water service authority will probably be the target of regulation and a separate channel to the regulator is desirable. In this, civil society can play an important role.

The differentiation in South African law between a water services authority and a water services provider may create some uncertainty as to who is being regulated. The opinion survey indicated that respondents thought all institutions should be regulated. In most municipalities, the municipality delivers the services itself and is then both authority and provider. Where another public or private entity provides the services in terms of a contract with the water services authority, this is sometimes referred to as regulation by contract. This is the approach adopted in the draft National Water Services Regulation Strategy, which regards the authority as a form of regulator. In the case studies there are examples of sub-national regulators but these are mainly where a private entity is the provider. Bearing in mind that the Constitution assigns the executive authority and right to administer water services to the authority (municipality), it is this entity that should be regulated by the national regulator. The (statutory) authority in turn complies with regulatory requirements by enforcing its contractual rights on the provider. Naturally, the provider must also comply with the law. Any arrangement whereby the national regulator directs its regulatory powers directly at the provider, would create an undesirable confusion between statutory and contractual obligations and the public and private branches of the legal system. Moreover, this could

Water Services Authorities
and Water Boards would be
the regulated institutions

be regarded as impeding the municipality's ability or right to exercise its powers or perform its functions and hence be in breach of the Constitution.

The water boards, which are constituted in terms of the National Water Act, would also be regulated entities.

The international cases were examined to determine the nature of skills that a regulator requires. It was found that there are a number of core skills such as finance, economics and engineering that are required irrespective of the range of aspects that will be regulated. If a wider range of aspects are to be regulated, as South African policy on the matter seems to indicate, then additional specialised skills are required. Examples are ecological and water sciences, social interaction and health. There is a national shortage in these skills. Using this information and South African cost data, a possible organisational chart for each of an independent and a departmental regulator were developed and costed. The departmental regulator would rely on the home department for a number of services (governance, financial management, etc.). The model suggests that, depending on the functions and mandate, it will require between 48 and 80 direct staff and cost between R40 and R67 million per annum. A similar estimate for an independent regulator suggests staff of between 65 and 112 and annual costs of between R63 and R99 million per annum.

The weight of international experience indicates that independent regulators are the most effective

the fact that there is a conflict of interest in DWAF simultaneously fulfilling the roles of enforcer, enabler and supporter and the failure to regulate effectively in the past. Those

favouring a departmental regulator mainly point to the cost and institutional proliferation, and regard regulation as a core governmental function that should not be moved from the line department. The weight of international experience indicates

The opinion survey found that stakeholders were divided on the choice between a departmental and an independent regulator. Those favouring

an independent regulator mainly pointed to

The general conclusion is that GATS holds minimal threat to introducing a new regulatory regime in South Africa.

that independent regulators are the most effective and therefore these researchers believe that the water services sector should follow the energy sector in South Africa and establish an independent regulator.

The research evaluated the potential impact of the General Agreement on Trade in Services (GATS) on water services regulation. It found that GATS *per se* would not affect water services in South Africa. However, the basis of GATS is that, through a negotiating process, a member state can add to its schedule of commitments those services that it opens to international trade. Any conditions that the member state wishes to apply to opening that sector are attached to the schedule of commitments. Once a sector is added to the schedule of commitments, the GATS national treatment principle ensures the equal treatment of foreign and local goods and services in the market. The commitment does not limit the power of a state to introduce a regulatory regime (subject to a “reasonability” test), nor does it affect the contractual relations between authorities and providers. It does mean that if an authority were to invite tenders from service providers, an opportunity must be given to international firms to compete. GATS itself is an inter-governmental agreement and private firms have no access to it or its appeal mechanisms and would have to rely on their governments to take up any challenge of a breach, on its behalf. The framing of the schedule is a complex technical matter and there is a shortage of skills on the topic and therefore the government will have to take care in making commitments. The general conclusion is that GATS holds minimal threat to introducing a new regulatory regime in South Africa.

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ACRONYMS AND ABBREVIATIONS

AFUR	African Forum for Utility Regulators
ASGISA	Accelerated and Shared Growth Initiative of South Africa
CSO	Civil Society Organisations
DEAT	Department of Environmental Affairs and Tourism
DME	Department of Mineral and Energy
DPLG	Department of Provincial and Local Government
DWAF	Department of Water Affairs and Forestry
GATS	General Agreement on Trade in Services (World Trade Organisation)
GEAR	Growth, Employment and Redistribution (Policy)
MDGs	Millennium Development Goals
MFN	Most-favoured Nation
NGOs	Non-Governmental Organisations
NWA	National Water Act, Act 36 of 1998
NWASCO	National Water and Sanitation Council (Zambia)
PPP	Public-Private Partnerships
RIA	Regulatory Impact Assessment
SALGA	South African Local Government Association
UN HDR	United Nations Human Development Report
WRC	Water Research Commission
WSA	Water Services Act, Act 108 of 1997
WSAs	Water Services Authorities
WSPs	Water Service Providers
WTO	World Trade Organisation

CHAPTER 1

1 INTRODUCTION

This work was initiated to feed independent research into the current DWAF initiatives to develop a regulatory strategy

Increasingly frequent incidents of non-compliance with potable water quality standards, the discharge of raw sewage into river systems and the deterioration in water supply system assets through operating deficiencies and lack of maintenance, has brought into focus the question of the regulatory framework for water and sanitation services. The Department of Water Affairs and Forestry has been developing a regulatory strategy based on the premise that the Department would be “the regulator”. The Water

Research Commission initiated this research to inform that debate and provide independent research into the topic. The research approach was to:

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- Integrate these reviews into possible regulatory models for South Africa;
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- Solicit the views of stakeholders;
- Prepare conceptual organisational models and estimate their costs; and
- Draw conclusions.

Access to water resources and water services in South Africa, as with so many other facets of policy in the country, has undergone major changes in the years following the election of the first democratic government in 1994. In the past, water services were provided along racially determined lines, with some sectors of the population enjoying a high degree of coverage while others received little or no service coverage. The new approach was summed up in the “some, for all, for ever” slogan used by DWAF. The goal of extending basic water services to all citizens is slowly being reached – in terms of the numbers who have access to a physical water connection. However, as with many countries internationally, this drive to extend water services coverage to those who previously did not have service, has coincided with two other trends. Firstly, water is increasingly recognised as having an economic value and as a scarce resource, including by the South African Water Services Act of 1997 (No. 108 of 1997) (WSA).

The other trend to note is on the promotion of the private sector for the supply of water services, as is also made possible by the Water Services Act, 1997.

The intersection of the policy objective of extending coverage, especially to the poor, and the modern economic realities of water provision mean that the “invisible hand of the market” cannot be relied on alone. As much as economics provides a framework for the promotion of water use efficiency, contributing to the achievement of economic and environmental sustainability, the third element of the internationally recognised trilogy in integrated water resource management, the social equity component, is missing.

The South African Constitution allows national government (DWA) to decentralise its power and attendant responsibilities. At the same time, it assigns executive authority and the right to administer water services to local government. The WSA provides further that the municipality is the “water services authority”. In this way, local government has the responsibility for the provision of water services. A municipality either can provide the

The South African Constitution assigns executive authority and the right to administer water services to local government.

service itself or can contract with private companies or other public entities, to manage and provide water services. However – the national government “bears the ultimate responsibility to ensure compliance with the state’s obligations” – as contained in the Bill of Rights of the Constitution. The Constitution recognises international law in the interpretation of the Bill of Rights. South Africa is a party to the International Covenant on Economic, Social and Cultural Rights of the United Nations, which specifies that states must provide “sufficient, safe, acceptable, physically accessible and affordable water” to their citizens¹. Thus, where water management services are provided with private sector involvement, the government “is in violation of its duty to fulfil its obligation to citizens if it allows private water companies to arbitrarily disconnect water taps or to adopt discriminatory or unaffordable increases in the price of water”. Overall responsibility remains with the central government to ensure basic access to water services – irrespective of whether they are provided by the local government or the private sector².

¹ Welch, A.R., (2005) Obligations of State and Non-State Actors Regarding the Human Right to Water under the South African Constitution. Sustainable Development Law and Policy Journal Vol V, Issue 1. American University, Washington D.C.

² Earle, A. Goldin, J. & Kgomotso, P. 2005: Domestic Water Provision in the Democratic South Africa – changes and challenges. Background paper prepared as part of the Nordic Africa Institute’s Conflicting Forms of Citizenship Programme. Uppsala, Sweden

Thus, it has to be accepted that for the foreseeable future there will remain a role for some form of intervention in the market – ensuring equity in water services coverage, as well as the application of water quality standards and environmental provisions. This intervention in the market is typically referred to under the catchall term of “regulation”. However, what is meant by regulation is not always clear. The goals, scope of powers, method of operation and involvement of civil society in regulation mechanisms differ the world over. Some models of regulation are focussed primarily on the economic aspects, others on service quality or environmental standards. Some operate under vaguely defined rules and operating procedures, while others have detailed legislation governing their activities. Regulators come in different forms – with various degrees of independence (from central government), sources of income and members. In South Africa, the current water services regulatory environment has been described as very fluid and unsatisfactory³.

Some models of regulation are focussed primarily on the economic aspects, others on service quality or environmental standards.

South Africa is now in the process of developing a water services regulatory strategy. This process is already at an advanced stage, where broad objectives and operational mechanisms for regulation have been developed. As a contribution to this process, this research project is premised on a usefulness to review and compare international regulatory practice. Lessons-learned and good practises can inform and be incorporated in the South African process.

This review starts with a desktop study of 16 case studies that were selected mainly because aspects of what they cover are considered relevant to the South African context and particularly because of comparable socio-economic circumstances. The concept of “pro-poor regulation” was a focus.

In the second phase of the review, the water services regulatory milieu in South Africa was analysed in terms of policy, legislation, socio-economic circumstances and sector institutions. This allowed a first indication of possible models that are applicable to South Africa.

In a parallel analysis, the implications of the General Agreement on Trade in Services (GATS) for water services regulation were studied.

³ DWAF. Emerging Institutional Models for Water Sector in South Africa. Institutional Re-Alignment Project. DRAFT 001. July 2008

In order to incorporate the ideas of important role-players in the sector, a questionnaire survey and a workshop were undertaken.

Finally, the case studies were revisited in order to extract information on the resources, particularly skills that a regulator requires.

This summary report is supported by five annexed interim and more detailed reports (the “deliverables”).

CHAPTER 2

2 METHODOLOGY

2.1 Introduction

This chapter describes the methodology used in the research. Most of the work was done by desktop study with a heavy focus on the internet. The views of stakeholders were obtained by a workshop and email and telephonic interviews.

2.2 The Case Studies

2.2.1 Purpose

This desktop analysis of international cases of regulation, their strengths and weaknesses, challenges encountered and approaches developed was undertaken to present a balanced overview of different international models of regulation. It is believed that this can critically inform the process of developing a suitable regulatory model for South Africa.

2.2.2 Focus on institutional issues

Since earlier research in South Africa, notably the studies and international literature reviews conducted by the Palmer Development Group (e.g. WRC Report No. 1383/1/04), largely focused on the methods of **economic** regulation, the focus of analysis in this review was on institutional aspects. Institutional aspects refer, amongst others, to the internal governance structures of the regulator, its rules for decision-making, powers and functions and means for compliance control and enforcement (see detailed list of institutional criteria below). The underlying assumption for this approach is that water services regulation, in a country like South Africa, with its relatively high levels of poverty, excessive skewness in wealth distribution and a history of denying large sections of the population access to water supply and sanitation, has to meet not only economic or financial but also social objectives.

The underlying assumption for this approach is that water services regulation, in a country like South Africa, with its relatively high levels of poverty, excessive skewness in wealth distribution and a history of denying large sections of the population access to water supply and sanitation, has to meet not only economic or financial but also social objectives.

2.2.3 Methodology for case study selection

As a first step, a scoping study of existing case examples on international models of regulation was undertaken. Information on different case examples was collected using sources such as online databases and primary (e.g. web pages of regulators) and secondary literature (academic articles).

2.2.4 Selection Criteria

The following selection criteria were used to reduce the number of cases for detailed analysis to sixteen:

- Developing countries vs. developed countries;
- Government regulator vs. independent regulator and others;
- Level of and improvements in service provision; and
- Availability of material.

The cases provide a wide-ranging overview of different regulatory models in countries with different socio-economic conditions and levels of water services provision.

2.2.5 The Case List

Developing countries with government as regulator

Ivory Coast

Brazil

Porto Alegre/ Brazil

Developing countries with independent regulators

Zambia

Mozambique

Chile

Buenos Aires/ Argentina

Developing countries with other regulatory models

Ghana

Dar Es Salaam, Tanzania

Cartagena, Colombia

Manila, Philippines

Kerala/ India

Developed countries

England and Wales

Germany

Italy

USA

2.2.6 Methodology for detailed analysis

In order to provide consistent analysis of the cases, an analytical framework was developed that consisted of the detail that was to be gathered for each case. Since the focus of analysis is institutional issues of regulation, the criteria largely refer to these aspects. The framework consisted of the following topics:

- Establishing the basic facts:
 - ▣ Level of regulation – national, local, provincial, etc.
 - ▣ Nature of the legislation – act, by-law, stand alone act, etc.
 - ▣ Funding of the regulator
 - ▣ Mode of governance of the regulator – who appoints board, who it reports to, etc.
 - ▣ Scope of powers – who and what does it regulate, and, compliance and enforcement
 - ▣ How is regulation carried out (does it investigate, do water boards have to submit reports, complaints from public, etc.)
 - ▣ History of establishment – changes in mandate, mode of operation, etc.
 - ▣ Is regulation focussed on private sector, public sector or both?
 - ▣ Pro-poor focus?
- International critique & opinion:
 - ▣ What is said
 - ▣ Who says it
 - ▣ Lessons and experiences
- Definition of water services regulation
 - ▣ Setting of rules
 - ▣ Monitoring
 - ▣ Enforcement
- Applicability to South Africa

After information had been collected on all the case, an analysis was conducted that sought to identify lessons and experience that could be useful in the South African context. By this time, the parallel task of describing the South African institutional, policy and legal frameworks was well underway and informed the researcher's views on what could be useful in the South African context.

2.3 Adapting International Best Practice to South Africa

2.3.1 Purpose

The purpose of this task was to review and analyse the South African context in order to identify those international lessons and best practices emerging from the case studies that could be adapted to South Africa. This main work was preceded by some conceptual work on the nature of regulatory frameworks in order to guide the review. An analysis of the poverty situation highlighted the basic notion that any South African water services regulatory system would have to be “pro-poor”.

The purpose of this task was to review and analyse the South African context in order to identify those international lessons and best practices emerging from the case studies that could be adapted to South Africa.

2.4 Scope of review

The desktop review covered:

- Regulatory concepts
 - The nature of South African poverty
 - Legislation
 - Policy
- Sector institutions
 - Other-sector regulation in South Africa

2.4.1 Findings

From the above analyses, preliminary determinants of a water services regulatory system were identified to carry into the further phases of the research.

2.5 The General Agreement on Trade in Services (GATS)

The GATS potentially limits the nature of regulation that can be practiced by a country if it has contracted to some of the provisions. It was therefore considered opportune to include a desktop analysis of the GATS in this research.

2.6 Survey

Survey techniques were used to capture the views of stakeholders. The first survey instrument was a questionnaire sent by email to 119 stakeholders. Unfortunately, notwithstanding attempts to improve returns, the response was low. Only 14 responses were received and of these five were from officials of DWAF. A shortened questionnaire, suitable for telephone interviews, was then prepared. Fifty interviews were conducted in this format. In addition, the

team made use of various opportunities such as sector meetings to record the views of stakeholders.

2.7 Workshop

A stakeholder workshop was held to present the findings from the earlier phases of the research and to capture further the views of stakeholders. The outcomes were integrated with those from the opinion survey.

2.8 Regulatory Capacity Estimate

The case studies and the literature review were revisited to determine the capacity, skills and resources needed for a regulator. This was all desktop work. NERSA and DWAF annual reports provided South African cost data.

CHAPTER 3

3 GENERAL REGULATORY FRAMEWORKS

This section distils international regulatory best practice from a general literature review and the case studies. The purpose of the chapter is to provide the general context within which the further analysis can proceed.

3.1 The Purpose of Regulation

At a practical level, the question of regulation arises because water services are a natural monopoly and in most societies the government is not the direct provider of water services. In South Africa's case, the function is spread across the spheres of government. Firstly, national government sets objectives directed at the overall welfare of the society but where services are provided by a separate sphere of government or entity such entity's objectives may not align

A conclusion is that all service providers, be they public or private, need some form of regulation

fully with those of national government. Secondly, the service provider will have greater access to information about the consumers and the markets. Left on their own there is potential for the service provider to use "private" information to gain market power to the ultimate detriment of society. A conclusion is that all service providers, be they public or private, need some form of regulation⁴.

One definition of regulation is⁵:

***Regulation** can be defined as a set of functions that ensure that water and sanitation service providers comply with existing rules and allow for those rules to be modified in order to cope with unforeseen events. In the water and sanitation sectors, regulatory functions can be broadly divided into three categories: economic (focusing on price and service quality), environmental (focussing on ecological sustainability), and public health regulation (focusing on drinking water standards). The way in which these functions are performed can have a significant impact on whether or not the poor have access to the service, and at a price they can afford.*

⁴ Sophie Trémolet and Catherine Hunt. Taking Account of the Poor in Water Sector Regulation. Water Supply & Sanitation Working Notes. Note No. 11. World Bank Group. June 2006. p6

⁵ Sophie Trémolet. Adapting regulation to the needs of the poor: Experience in 4 East African countries. BPD Research Series. May 2006.

A regulatory framework consists of the set of rules and processes that bind the water and sanitation service providers, including formal rules (laws, contracts, by-laws, etc.) and informal rules (personal commitments, financial incentives, reputation, etc.) it also defines how the main regulatory functions are allocated to various institutions, which can include an autonomous regulatory agency, a ministry, an asset-holding company, a customer group, an independent expert, etc. As the poor often suffer from limited access to services, regulatory frameworks should generate increased access to water and sanitation services and improve the nature of this access with regards to the availability, affordability and sustainability of these services.

3.2 Regulatory Governance

Governance in the public sector sense refers firstly to the relationship between the government (usually represented by the minister), or in some cases the parliament, and the regulatory institution and secondly to the manner in which this relationship is defined in the establishment instrument and by legislation, regulations, policy and custom. The objective of good governance is to ensure that the regulatory authority is true to its mandate, accountable to the minister (usually) and compliant with all law and regulations. It must be empowered to pursue the characteristics of good governance including predictability, accountability, transparency and responsiveness.

It is self-evident that a government can design a regulatory system that will best pursue the broader objectives of society by determining the governance system. Variables that the government has at its disposal for the institutional design process are defining the mandate, powers and function of the regulator (including the level of autonomy and reporting mechanism), the appointment of board members and the financing mechanism.

The Regulator must be empowered to pursue the characteristics of good governance including predictability, accountability, transparency and responsiveness.

Whatever the governance system it must cause the regulator to possess three principal qualities, namely competence, independence and legitimacy⁶.

⁶ Sophie Trémolet, Padmesh Shukla and Courtenay Venton. Contracting Out Utility Regulatory Functions. Reference 0002524. Environmental Resources Management for the World Bank. January 2004. p10.

According to the African Forum for Utility Regulation (AFUR)⁷, a competent, balanced regulatory agency needs skilled management, preferably with a clear separation of the governance structure (policy focused) and management (execution oriented). The key requirements for utilities to function well are well-defined regulatory objectives, roles and responsibilities. For best practice to be achieved, the regulatory organisation needs to possess certain structural characteristics. AFUR identifies nine principles of best practice regulation to be communication, consultation, consistency, predictability, flexibility, independence, accountability, transparency, effectiveness and efficiency.

The financing of a regulator can also become an important issue⁸. The finances available to the regulator must be predictable and not unreasonably subject to political discretion. However, the resources available to it should not be disproportionate to the resources generally available to

The finances available to the regulator must be predictable and not unreasonably subject to political discretion.

other institutions in the sector. Ideally, it should be linked to a sector measure such as a percentage of turnover so that the extent of financial resources available to the regulator relates to its regulatory function. It has been suggested that in Asia “governments rely too heavily on under-equipped and unsupported independent regulators to carry out tasks that are beyond their capabilities”⁹. Similarly in Ghana the regulators have struggled to find adequate staff

because of funding difficulties¹⁰. Even in the United States, where there is a long tradition of independent regulatory commissions, information and staff expertise can be inadequate for the task¹¹.

⁷ AFUR Regulatory Governance: Background paper for the Fourth Meeting: Pretoria, South Africa, 5-7 November 2002

⁸ Hodge J. A Regulatory Framework for Economic Regulation of Network Industries in South Africa. Prepared on behalf of the Office of the Presidency. Development Policy Research Unit. University of Cape Town 2008.

⁹ Jacobs, S. Governance of Asia Utilities: New Regulators Struggle in Difficult Environments, The Governance Brief, issue 10, Asian Development Bank. Governance and Regional Cooperation Division. 2004

¹⁰ Aryeetey, E. The Institutional and Policy Framework for Regulation and Competition in Ghana, in P. Cook, C. Kirkpatrick, M. Minogue and D. Parker (eds.) Leading Issues in Competition, Regulation and Development. Edward Elgar. 2004

¹¹ Paul L. Joskow. Regulatory Priorities for Reforming Infrastructure Sectors in Developing Countries Annual World Bank Conference on Development Economics, Washington, D.C., April 20-21, 1998. p26.

3.3 Regulatory Functions

The priorities of government determine the institutional design of the regulator and the assignment of a range of functions. The functions that may be assigned to a water sector regulator can be classified as^{12,13}:

- **Economic Regulation** providing for services at a price that balances the affordability for the customer with the long term financial sustainability of the provider while encouraging efficiencies in service provision; this is most pertinent for private sector providers;
- **Social Regulation** that ensures that social objectives of society are met, e.g. universal access, and generally that service provision is pro-poor;
- **Service Quality Regulation** that extends mere access so as to include the dimensions of reliability, pressure, customer interface, etc.;
- **Water Quality Regulation** that ensures the water supplied is fit for purpose; in many jurisdictions it may be the responsibility of a health department;
- **Consumer Protection Regulation** that ensures there is balance in the power relationship between consumers and suppliers; and
- **Environmental regulation** that ensures that the costs of water supply and sanitation are not externalised to the environment: In the water sector this relates particularly to wastes.

The international debate about regulation is about seeking alternatives to the classical form of hierarchal government where the rules are set in the form of regulations and government strictly enforces compliance with the law.

3.4 Regulatory Approaches

A number of basic approaches to regulation can be identified. The approaches are not mutually exclusive and a particular set of circumstances is best served by a unique blend or hybrid. Some of the approaches are also linked to the institutional form of the regulator and may be limited by it.

3.4.1 Command and Control

This is the classical form of hierarchal government where the rules are set in the form of regulations and government strictly enforces compliance with the law. Inefficiencies in

state regulation have been identified by one source as a primary cause of poor economic

¹² Eric Groom, Jonathan Halpern, and David Ehrhardt. Explanatory Notes on Key Topics in the Regulation of Water and Sanitation Services. Water Supply and Sanitation Sector Board Discussion Paper Series. Paper No 6. The World Bank. June 2006. p8.

¹³ Sophie Trémolet, Padmesh Shukla and Courtenay Venton. Contracting Out Utility Regulatory Functions. Reference 0002524. Environmental Resources Management for the World Bank. January 2004.

performance¹⁴ and the international debate about regulation is about seeking alternatives to this approach. In fact, it has been said, “*regulation reform now represents one of the main pillars of the Post Washington Consensus on economic development*”¹⁵.

3.4.2 Competition

All competition approaches to regulation are based on the premise that competition will increase efficiencies and the market responsiveness of providers.

3.4.3 Information Gathering and Analysis

This regulatory approach is concerned with the extensive and intensive gathering and processing of information for the purpose of ensuring transparency and allowing the stakeholders of a service provider to hold it accountable for the service it provides.

3.4.4 Incentives

The concept of incentive regulation is for the regulator to enter a level of detail in the operations of the provider by setting up, usually financial, incentives for the provider to achieve specific desired outputs.

3.4.5 Contract “Regulation”

The relationship between a water service authority and a water service provider is fully defined in a contract.

3.4.6 Self-regulation

This is the approach where for example a municipality itself provides the services without any regulation from outside the institution. This is largely the current situation in South Africa.

3.5 The Tasks of Regulation

A water sector regulator can expect to have to perform some or most of the following tasks in order to fulfil the functions assigned to it:

- Investigations into licence applications;
- Monitoring and ensuring compliance;
- Undertaking general research (social, economic, financial, etc.);
- Auditing financial statements of regulated entities;
- Investigating collusion or restrictive practices;

¹⁴ World Bank. *Doing Business in 2004: Understanding Regulation*. World Bank/Oxford University Press. 2004.

¹⁵ Onis, Z. and Sentes, F. *Rethinking the Post Washington Consensus*, *Development and Change*, 36(2), 2005. pp. 263-290.

- Dispute resolution;
- Regulatory impact assessment studies;
- Interaction with consumers and stakeholders; and
- Forming legal opinion.

3.6 Regulatory Powers

A regulator must be assigned sufficient legislated powers to carry out its functions. These must be formalised in the legislative instrument by which the regulator is set up. The powers may include:

- Formal authority for issuing licences, directives and cautions;
- Recommendations to authorities with greater enforcement power;
- Allocation of subsidies, grants and incentives;
- Public participation in the regulatory process;
- Publishing comparative information;
- Enforcement through the courts; and
- Praise and shame publicity.

A regulator must be assigned sufficient legislated powers to carry out its functions.

3.7 Characteristics of Pro-Poor Regulation

Pro-Poor regulation is a catchall concept in which the broad priority objectives of regulation relate to the relief of poverty through equity in access to services and their affordability. It is a relatively new concept and relatively little practical work has been done on the topic¹⁶. Pro-poor regulation is characterised by:

- General sensitivity to the plight of the poor reinforced by intensive information gathering about their circumstances;
- Strong focus on consumer protection and the promotion by the regulator of special community-level institutions to act as channels for complaints such as in Zambia (Water Watch Groups) and in Mozambique;
- A developmental approach is nurtured;

Pro-Poor regulation is a catchall concept in which the broad priority objectives of regulation relate to the relief of poverty through equity in access to services and their affordability.

¹⁶ Sophie Trémolet. Adapting regulation to the needs of the poor: Experience in 4 East African countries. BPD Research Series. May 2006

- Tariff setting that differentiates on the basis of affordability (Cartagena case study);
- Priority attention to the expansion of services to those not yet served;
- Highly developed mechanisms for public participation;
- Tripartite partnerships between the public, private and civil society sectors;
- Accessible complaint channelling mechanisms;
- Flexibility in the adoption and application of rules and standards particularly in the trade-off between cost and service quality dimensions such as pressure and reliability (but not water quality); and
- Flexibility with or separate systems for informal community level providers.

3.8 Use of Regulatory Incentives

Incentive regulation is one of the approaches used by a regulator that is best suited to private sector operators. Incentives are usually financial but may also include others such as grant funds for new services (see Zambia case study) or contract extension in time or area. A number of relatively complex financial arrangements usually form the basis of the incentive.

3.9 Regulatory Impact Assessment (RIA)

In recent years, regulatory impact assessment has become part of international practice. The concept is that no policy or regulation should be introduced without an intensive examination of the impact it will have on those affected by the proposed measure and of the costs that will be incurred by them and the state. One core idea is that regulation is a risk-based activity. During the development of the concept, five principles of good regulation were developed as:

- proportionate – to the risk;
- accountable – to ministers and Parliament, to users and the public;
- consistent – predictable, so that people know where they stand;
- transparent – open, simple and user-friendly; and
- Targeted – focused on the problem, with minimal side effects.

The European Union has also adopted the RIA process with a focus on policy impact assessment: *“Impact Assessment identifies the likely positive and negative impacts of proposed policy actions, enabling informed political judgements to be made about the proposal and identify trade-offs in achieving competing objectives”*¹⁷. The EU adds the principle of subsidiary namely that the Commission will only undertake actions that are necessary and effective.

¹⁷ Commission of the European Communities. Communication from the Commission on Impact Assessment. COM(2002) 276 final. Brussels, 5.6.2002.

In South Africa, RIA was introduced in ASGISA¹⁸ for the purpose of reducing or eliminating the negative unintended consequences of laws and regulations, especially on job creation. It is now apparent that any new regulatory regime will have to go first through the RIA process.

3.10 Regulatory Institutional Forms

Recent international thinking favours institutionalizing utility regulation by establishing separate authorities or commissions that are legally separate from the government

Classically, government itself provided regulation mainly by making legislation, regulations and policy with minimal attention paid to compliance. However, more recent international thinking favours institutionalizing utility regulation by establishing separate authorities or commissions that are legally separate from the government¹⁹. Conceptually, the task of interpreting and applying legislation and regulations falls to the independent regulator while the functions of policy-making and legislation remain with government. However, this split is not always clear-cut

and the boundary may depend on the strength and reputation of the regulator and the degree to which it has the legitimacy and political backing to make or recommend decisions that have substantial policy implications²⁰. Regulators have generally been set up as part of sector institutional reform. In Great Britain and Mozambique water regulators were set up to manage the advent of the private sector while in Zambia the regulator is for both public and private operators. In some countries, a single regulator has a multi-sectoral mandate.

Some commentators are more sceptical about independent regulation in developing economies. One is of the view that “*the realities of poverty and underdevelopment minimise the applicability of models of independent regulation to developing countries*”²¹. Another, while conceding that independent regulation may be the best option in the long run, suggests that in the meantime the political systems and cultures within developing countries means rather developing or improving regulatory systems **within** government²².

¹⁸ Republic of South Africa. Accelerated and Shared Growth Initiative of South Africa (Asgisa)- a summary. 2005 para 8

¹⁹ World Bank. INF Network – Regulation and Institutional Design. <http://worldbank.org>. 6 June 2006.

²⁰ Sophie Trémolet and Catherine Hunt. Taking Account of the Poor in Water Sector Regulation. Water Supply & Sanitation Working Notes. Note No. 11. World Bank Group. June 2006. p10.

²¹ ID 21 Insights. Issue No 49. www.id21.org

²² Black J. Critical Reflections on Regulation. Discussion Paper No 4. Centre for Analysis of Risk and Regulation. London School of Economics. Jan 2002

There are really only two basic forms of regulatory institution namely by government line departments or by independent regulator. Within this broad split, the powers and functions can vary significantly to accommodate particular circumstances. The section that follows attempts to integrate South African circumstances with international practice as the basis for a “pro-poor” regulatory system.

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CHAPTER 4

4 FINDINGS FROM THE INTERNATIONAL CASE STUDIES

4.1 Introduction

This section of the report provides a synthesis of the experiences and lessons drawn from each of the case studies provided in the literature but with specific reference to their applicability for South Africa. While the nature of the countries varied as much as the approach to regulation, the value in this diversity is that it provides a substantial resource base from which one can draw.

4.2 Key points from international experience and best practice

This summary report only highlights particular aspects of the cases. More detailed information on the case studies is provided in Annexure 1

4.2.1 Chile

Superintendencia de Servicios Sanitarios (SISS) regulates privately owned water companies but not the publically owned. SISS is a decentralised public entity with financial independence, which reports to the President of the Republic via the Ministry of Public Works. The key point from this case is that Chile has a dispute resolution mechanism, which is a part of its regulatory framework and serves as a good example of how one should operate in the context of regulation.

This is particularly significant for South Africa in the context of its own regulatory framework, since all regulated environments require a strong dispute resolution mechanism. In Chile, arbitration proved to be faster and cheaper than the court system and allowed sector expertise to be used as the appointed arbitrators. The limitation of the Chilean case is that only tariff setting disputes were subject to arbitration. It might be feasible and perhaps even preferable in South Africa to broaden the scope of matter that is subject to arbitration.

Chile uses arbitration for the settlement of disputes between the regulator and the regulated service providers

4.2.2 Columbia (Cartagena)

This case study is interesting from the institutional perspective because the regulator, Comisión de Regulación de Agua Potable y Saneamiento Básico (CRA) (a water sector specific institution although established under general legislation), sets the regulations but a separate institution, Superintendencia de Servicios Públicos Domiciliarios (SSP) (which is a multi-sectoral institution with a water and sanitation department that was established under the same law) is responsible for monitoring and enforcement.

The **Colombian** case is interesting to South Africa because a new Constitution devolved a previously centralised system of service delivery to local governments that were ill equipped to carry the responsibility.

The Colombian case is also interesting to South Africa because a new Constitution devolved a previously centralised system of service delivery to local governments that were ill equipped to carry the responsibility. The national regulatory model is applied to “water companies” that are wholly owned by the municipalities (in South Africa the equivalent would be a municipal entity in terms of the Municipal Structures Act) but also to the case of Cartagena that is a joint venture between the municipality and a private company.

Noteworthy is the World Bank’s assessment that the system, with about 1300 service providers, was not effective in ensuring that the regulations were complied with, particularly where tariffs were concerned. The role of civil society organisations, which were instrumental in creating local political pressure for less expensive services, over-rode the CRA’s determination of institution-sustaining tariffs and had the central government continue subsidising service providers.

In light of this case, clear lines of authority and regulatory roles of the various departments involved in service delivery in South Africa will have to be more clearly delineated. Moreover, caution in avoiding the overlapping of regulatory authorities and/or functions was the underlying lesson from this case study and is relevant for both DWAF and the Department of Provincial and Local Government (dplg). This case study also highlights the difficulty where the regulatory role of local government becomes confused by its participation in a joint venture with the private sector.

4.2.3 Cote d'Ivoire

The Cote d'Ivoire example is one where a monopoly private sector provider was regulated by powers dispersed between several state departments. The regulatory regime and a lack of competition, gave rise to the service provider becoming financially dependent on the government. It also raised questions about the effectiveness of government agencies themselves doing the regulating, a matter of significance for South Africa. By not being independent from the government there may be an impact on the regulator's ability to enforce

Cote d'Ivoire is an example of the difficulties that can be uncoupled where the regulatory role is not clearly defined and assigned to one institution

compliance, where non-compliance by the provider is due to government's non-payment of water bills. The argument for an independent regulator or for precise clarity on the functions of a government regulator needs to be distinguished from other water management responsibilities. Currently, DWAF and the South African water sector have not resolved the debate and the experiences of Cote d'Ivoire should be included in future deliberation.

Another important issue raised was that regardless of where the regulator institutionally resided, a willingness to fulfil its monitoring and enforcement role coupled with the necessary mechanisms and capacity were essential for successful regulation.

4.2.4 England and Wales

The regulator, the Water Services Regulation Authority (still known as "Ofwat" from an earlier acronym) is a corporate entity that is not subject to direction from Ministers. It is accountable solely to Parliament and regularly provides evidence to select committees. It works in an environment where the water industry is entirely privatised and Ofwat is set up solely as an economic regulator. A possible lesson for South Africa is how, in the context of privatisation, good economic regulation can be pursued. While the same dexterity may not apply to South African local government, the Ofwat model presents a basis for economic regulation on the whole. While it

England and Wales is an example where OFFWAT is a single purpose economic regulator.

It is also interesting because OFFWAT is not subject to ministerial direction but reports directly to Parliament

does offer mechanisms for the protection of consumers, there is no pro-poor focus. Another limitation is the (what some in the South African water sector see as artificial) divide between water resources and water services. Ofwat is not a replicable or suitable model for South Africa, however; it offers an abundance of information sheets, guides and other publications on its functions and processes that would be invaluable information for any other regulator.²³

4.2.5 Germany

Germany is an example of self-regulation at municipal level in a developed country demonstrating that this is possible where the municipalities are strong institutions

Germany vests regulatory authority entirely in its municipalities, i.e. there is self-regulation. German municipalities are sophisticated and well resourced and are able to achieve high levels of good quality services although at relatively high cost. In South Africa, most municipalities are politically and administratively much weaker and cost is more important. The model is thus not appropriate for South Africa. It is however worth noting that there have been inefficiencies in German service delivery because of a lack of competition aggravated by the fact that management responsibilities and regulatory authority are de facto placed in one hand.

4.2.6 Mozambique

The main lesson for South Africa from the Mozambican case is the importance of ensuring an appropriate institutional set-up for the (independent) regulator. In this case, where there was sector-wide reform, it was found that the regulator should be established well in advance of the selection of operators. The Mozambican case, like the Cote d'Ivoire one, shows that the independent regulator option brought improvements in service delivery and was widely regarded as preferable to the earlier "government-does-all" model. The CRA was credited with facilitating many of the advances that broader sector reform achieved. It also demonstrates that the appointed regulator has to be trusted by all parties, if benefit is to be realised. Apart from being independent and trustworthy, the regulator, it is argued, should also be centrally placed and be in partnership with the municipalities. The Mozambican case offers many potential lessons for South Africa and deserves additional detailed research.

The **Mozambique** case is a success story of an independent regulator in a developing country

²³ Ofwat. Publication List (10 February 2006). Available on www.ofwat.gov.uk

4.2.7 Ghana

The Ghana case is another example of an independent regulator. In this context, the government agency/department (DWAF in the case of South Africa) that currently fulfils the role of regulator has to be willing to handover the control and function to the newly appointed regulator. If political influence over the regulatory body is to be avoided or curbed, its funding should be independent of government short-term decision making. In Ghana, the regulatory agency, the Public Utilities Regulatory Commission (PURC), is financed by the government budget with the result that they do not necessarily receive sufficient funds to cover their approved budget. Apart from making planning and operation both difficult and inadequate, staff cannot be retained when salaries are not paid. This is further exacerbated by making the release of funds subject to the regulators' compliance with political instructions. These circumstances seriously limit the independence and authority of the regulator and effective regulation is impossible.

Ghana demonstrates the importance of the regulator being financially independent of the political budgeting process

4.2.8 Zambia

The National Water Supply and Sanitation Council (NWASCO) is established as a body corporate under the Water Supply and Sanitation Act. NWASCO regulates the provision of urban and peri-urban water by government and private companies while rural water supply is undertaken by government and is outside the regulatory net.

In the establishment phase it is important that the changes to the legal and institutional framework, as well as the transformation or establishment of new institutions, are done in a realistic time frame. There needs to be clear vision on the part of policy makers who in turn can ensure that guiding principles are available, understood and adhered to throughout the process. In some instances, a temporary reform programme structure would need to be established first, to manage the reform with a large degree of autonomy and professionalism. A point mentioned in several of the earlier cases and reiterated by the Zambian case is the importance of strong political will for change. This example goes a step further and motivates for sufficient stakeholder involvement, which is seen as key to gaining acceptance and support for successful implementation. Another important point and of relevance to South Africa, is that regulation is a fairly new process, and as such the framework and regulatory processes should

have sufficient flexibility for adjustments to the process and strategies as and when the need arises.

The transition from a temporary reform structure to permanent institutions has to be carefully managed and should be organised according to key issues rather than professional fields. Due to the nature of the process and the learning curves inherent in it, unrealistic expectations and unacceptable practices need to be addressed through constructive engagement during the implementation of the reform. A critical point is that sector reform is never complete and as such the need for a permanent sector coordination body with autonomy to restructure or create new institutions is essential. Adequate preparation and human development for senior management is crucial for effective operation. The regulatory regime should also be tailored to the specific challenges in the country.

Water Watch Groups have been established and are supported by NWASCO to increase the consumer's role in the monitoring process. WWGs mediate disputes between consumers and providers.

Water Watch Groups increase the consumer's role in the monitoring process and mediate disputes between consumers and providers.

Brazil demonstrates the difficulty of adopting foreign models and the complexity of regulation in circumstances where responsibilities are unclear, in this case because of the federal nature of the state.

The licensed providers pay 2% (originally 1%) of their turnover as licence fees to the regulator.

4.2.9 Brazil

The Brazilian case emphasises the fallacy that replication of models from other countries can succeed without regard to social, political and economic context. In Brazil, merely adopting models from Europe and the United States has not led to improvements in environmental or social quality, because the cost, affordability, and the timing of the introduction of standards were not evaluated, nor were practical approaches developed for implementing them.

Reviewing current international models of regulation is an exercise that every country contemplating regulatory reform should embark on but contextualising and adapting aspects of the model to one's own specific criteria and context, is imperative.

The case highlights the complexity of regulation in a federal state where the separation of the authorities and responsibilities of the federal and constituent states are not clear. While Brazilian states have a far greater degree of autonomy than South Africa provinces, nevertheless this problem resonates with the characteristics and content of national and provincial competencies.

4.2.10 Brazil (Porte Allegre)

Because Brazil is a federal state the regulatory regime varies between states. This is a city case within Brazil where local government regulates its own monopoly public utility. The establishment of the *Departamento Municipal de Agua e Esgotos* (DMAE) as a public water utility with certain degrees of autonomy made the institutional arrangement a workable one. The lines of authority were clarified and the DMAE knew that they were to be held accountable. The body overseeing the DMAE ratified the powers of the “discretionary council” and was clear as the regulator of the DMAE. Participatory democracy was at the centre of the approach of service delivery and regulation. Decisions were made jointly and were people-oriented. All the DMAE staff members were focused on listening to and addressing complaints, while the discretionary council made room for debate and discussion that could lead to positive impacts on the ground. This model with an emphasis on participation and ensuring citizens’ voice is important for South Africa in light of the regulatory strategy having an orientation in that direction.

Water quality and the budget are other aspects of DMAE’s operations that are regularly subject to public scrutiny. South Africa has been experiencing several problems around water quality at smaller municipalities and apart from the capacity constraints; South Africa is also faced with inadequate regulation of water treatment plants. Through the inclusion of citizens, the responsibility for water quality regulation is a shared one.

The tariff structure, instead of providing universal access, looks at provision for poor households and the

Porte Allegre is a successful example of self-regulation at the municipal level by establishing a separate regulatory unit

Participatory democracy was at the centre of the approach of service delivery and regulation

Poor households only pay marginal costs for the first 20kl/month

7marginal costs for using up to a basic 20 kilolitres a month. Higher consumption and commercial use are charged exponentially higher to recover all costs – much like the rising block tariff system used in South Africa. In this case-study the “discretionary council” with its regulatory powers, the nature of its engagement with the DMAE as a regulator and the DMAE’s own commitment and self-regulation of its finances and quality of service, had led to a good water and sanitation service. It has withstood, pressures to privatize and is seen as one of the most successful models for water and sanitation. This is critical in light of the financial and capacity constraints facing DWAF and municipalities in the context of the Free Basic Water (FBW) Policy. In South Africa, the aim is to provide universal access; Brazil provides a pro-poor approach to FBW with concrete regulation.

It is important to note that this form of regulation is not in the traditional form of laws and regulator and hierarchical relations. What makes this case stand out is that the regulator and the body being regulated work in harmony, being mutually dependant on each other and having a sound relationship based on understanding and a common commitment to serve the interest of the user. This includes the poor. They work in a democratic, inclusive and participatory manner.

4.2.11 India (Kerala)

Regulation tends to be seen as something that requires an external institution with sophisticated legislation and governance. In the case of this rural community in India /Kerala, questions are raised about the form regulation should take as well as the rural-urban dichotomy – many of the case studies presented have had an urban bias and it seems to permeate the literature on regulation. The case study on Kerala raises issues and lessons from which we can draw and adapt in relation to regulation of water services and schemes in rural areas.

Kerala is an example of self-regulation in rural water supply

The first major lesson is the commitment by government to true participation by local people or communities. Secondly, the communities themselves being committed to improving their own lives and setting up a system that is transparent and which ensures authentic yearly audits of the finances (corruption must be combated if this approach is to work). Thirdly, the community and existing structures must work together – in South Africa the induna and the tribal authority, would work like the village panchayat (village council). They would be collaborative in both monitoring and implementation; and be responsible for assisting with financing the scheme in a manner, which ensures economic rather than physical access. The use of local skills, expertise

and labour creates a sense of ownership and control; and is integral to the success of the scheme.

Another important ingredient is that while there is an appointed committee, which attends to the management, the overall responsibility still lies with the local people and consequently local participatory and democratic governance is achieved. This model does not suggest that the state abdicate responsibility for delivery but that in rural areas, where capacity and resource constraints exist, the assistance of local communities and their existing capacity and support can help implement and maintain the services required. The essence of its success is that the schemes should be a movement by the people, owned by the people and with the support of local and national government. Furthermore, the success of this model hinges on the commitment by the state to support people-focused initiatives, which are driven from the bottom up, participatory, transparent and free of corruption.

One threat, which perhaps is not of significance for South Africa per se, is often the conditions enforced by international financial institutions (IFIs). Governments have to be self-reliant in funding of regulation since IFIs will generally seek a framework of cost recovery or complete privatization of schemes. This in essence undermines local capacity and participation and changes the self-regulatory model to a form, which is much more sophisticated, complex and in many instances is not able to boast the same level of success.

4.2.12 Philippines (Manila)

This case involves an international company obtaining a concession that was regulated by local government. South Africa has relatively few private sector concessions or management contracts, those held by WSSA, SIZA Water, Johannesburg Water (Suez) and Cascal being the best known. Currently, the local municipality, or its contract management unit, “regulate” the contract.

However, in most instances these institutions, with some exceptions among the CMUs, have been ill equipped to fulfil this function. The case of Manila in the Philippines, while the dynamics are different, holds similar lessons in terms of capacity constraints.

In addition, the Manila case is reportedly fraught with corruption and raises alarm bells for what can happen if politics are not separated from regulation. The case study highlights how a lack of political-will and corruption within the central government, made the Regulatory Office

Manila is a case where a poorly resourced and politically influenced local government regulator was unable to effectively regulate a private international company

beholden to the government and resulted in inefficiencies. Political manoeuvring and influence largely determined the tariff structure and resulted in escalating water costs for citizens. For effective regulation, the failure from Manila stresses the need for a regulator with sufficient powers that are ensured through legislation and other statutory safeguards.

The case in Manila is a good example of why independent regulation and independent funding of the regulator, is important.

A feature of the Manila case is the concessionaire's access to international arbitration in the event of dispute. The Arbitrator should, as illustrated by the Manila case, be independent of political and financial influence and corruption. This mitigates one of the perceived risks and is said to encourage international private sector participation.

Another important point, and one also raised by the Zambian case, is taking sufficient time in setting up a regulatory framework that is grounded and well thought out.

The Citizen Utility Boards (CUBs) serve as a positive model of how education, legislation, economic development and public participation all acting in congruence leads to effective regulation

4.2.13 USA

A regulatory framework that has public participation at its core seems to be a very successful model in the USA. The combination of strong participation by users as well as having the necessary expertise within the regulatory body has made for successful regulation through ensuring that water utilities comply with national and state legislation. The Citizen Utility Boards (CUBs) serve as a positive model of how education, legislation, economic development and public participation all acting in congruence leads to effective regulation of the water utility and allows for solid intervention with the necessary mandate and expertise.

Having the goals of the regulator set out, as well whose interests it is to serve, is vital. Having those interests represented on the membership and board of the regulator is also a key factor to attaining success.

Consumers monitor the service to ensure that their rights, as defined in legislation related to the service, are complied. If the service provider is not in compliance, they use their voice and organisation to articulate and pressure for change. The CUBs are voluntary organizations

funded through contributions from their members. The law creating the CUBs permit them to recruit members through account inserts where consumers can then tick off contributions to the CUBs. These are added to the regular utility account and the utility transfers the funds to the CUBs. All members who make a minimum contribution have voting rights to elect a board of directors for the CUB. The board of the CUB oversees staff appointments and represents residential consumers in the proceedings of regulatory agencies, legislative bodies and other public processes that impact utility rates or services.

The application of the model lacks a strong pro-poor focus and a concern is that communities unable to fund a CUB could well be at the mercy of water service providers with little recourse to enforcing compliance with legislation.

4.2.14 Dar es Salaam, Tanzania

This case study is one where national legislation transformed an existing municipal institution into an authority that owned water supply and sanitation assets and had responsibility for service provision but leased the assets to an operation company and regulated through the contract. It demonstrates the difficulties of local regulation that is contract based.

Dar es Salaam is an example of unsuccessful “regulation-by-contract”

The agency responsible for the provision of water and sanitation services in Dar es Salaam is the Dar es Salaam Water and Sewerage Authority (DAWASA). In 2003, this authority entered into a lease agreement with City Water Services (a Tanzanian registered company but with international shareholders, notably BiWater). DAWASA regulated the contract but it was cancelled in 2006 because of disputes surrounding progress with the investment programme. A new state-owned organisation took over the water supply. According to the World Bank’s 2007 project progress report, the change has not adversely affected the investment programme.


As this regulatory case study, was so short-lived it has not produced meaningful regulatory lessons although it is fruitful ground on privatisation issues.

4.3 A general comment on citizen’s participation

An aspect of regulation that is particularly significant in many of the case studies is the incorporation of citizen participation although approaches varied considerably between cases. In Bolivia, Chile, New Zealand, and Argentina citizen participation was forthright and direct. However, citizen participation was not always recognised as an integral aspect of regulation.

Some of the literature tended to present the view of regulation as being that between governments and service providers with citizens on the sidelines. Another approach to citizen participation is that found in countries like Brazil, India and the USA. In these countries, participatory processes, which enable civil society and citizens in general to get involved, articulate and engage around the issues of regulation, serve as positive examples of citizen participation as an integral part of regulation.

The socio-political context of South Africa is to a large extent conducive to the participatory approach. Both the Porto Alegre people's budget approach in Brazil and the collective participation of communities and local government in rural areas seen in Kerala, India serve as constructive examples of how regulation can be approached in the diverse context of South Africa. Both of these cases offer opportunities and lessons for both the urban and rural contexts.



Participation is a key feature
of many regulatory models

The second form of citizen participation also bears strongly on South Africa. Civil society and social movements currently, while not a force in South Africa, can potentially be catalysed into becoming one, if proper mechanisms for participation and regulation are spelt out.

Another important issue that emerged from two case studies was that of the ombudsman as a way of recourse for citizens. The ombudsman is able to challenge legally service providers who were in violation of their duties towards citizens, especially in a context where the regulator was either too weak or unable to do so.

4.3.1 Additional cases specifically on the role of civil society in regulation

France (Grenoble)

The Grenoble case shows a grass root organizations that in the absence of formal mechanisms for participation in local government decisions, operated through a combination of ties with minority local politicians and instituted carefully documented lawsuits. As a result, from 2002, French towns with more than 10,000 inhabitants are legally required to set up local consultative commissions on issues of local public services. It remains to be seen, whether such an institution will formalize public participation and create sufficient space for current concerns to be raised.

Chile

Chilean civil society had not been very strong in participating in the water regulatory process and it was only after many years of privatization that engagement was precipitated. An

outcome of this engagement was having essential services placed under the remit of the ombudsman.

Argentina

NGO consumer associations contested the involvement of the private sector and the terms on which water was supplied. This included widespread payment boycotts along with more visible protest such as marches and demonstrations. The Ombudsman played a vital role in this context by, lodging court cases that challenged key aspects of the terms of delivery.

Bolivia

When the Bolivian water regulator moved under its new powers to establish a private concession contract for water services in Cochabamba, the inter-institutional commission structure established to negotiate with the primary bidder included, unofficially, the president of the Civic Committee, an NGO formed to represent the interests of consumers.

Informal participation can also be effective

CHAPTER 5

5 ANALYSIS OF SOUTH AFRICAN POVERTY

This section is undertaken to demonstrate the importance of a pro-poor approach to regulation in South Africa but describing the extent of poverty and the inequity in access to water and sanitation services.

5.1 Background

Poverty and the poor have been an issue of discussion from the beginning of South Africa's new democracy. In 1996, the total poverty gap (see further detail below) was equivalent to 6.7% of gross domestic product (GDP); by 2001 it had risen to 8.3%. The 2001 poverty line for a household of five was R1 541, which is less than US\$200 (using 2001 exchange rates). The fact that poorer households have not shared in the proceeds of economic growth was reflected in the rise in inequality between rich and poor²⁴. To measure inequality the Human Sciences Research Council (HSRC) used the Gini coefficient, which varies from zero in the case of a highly even distribution of income, to one in the case of a highly unequal distribution. South Africa's Gini coefficient rose from 0.69 in 1996 to 0.77 in 2001, indicating it had one of the most unequal distributions of income in the world. Furthermore, the report supports a point made earlier that past inequality in South Africa was largely racially defined; however, it added that it is now increasingly being defined by inequality within population groups as the gap between rich and poor within each group substantially increases. Moreover, new estimates of poverty in South Africa show that the proportion of people living in poverty had not changed significantly between 1996 and 2001 and that the situation of households living in poverty has worsened as the divide between rich and poor grew²⁵.

South Africa has one of the most unequal distributions of income in the world

²⁴ HSRC, Craig Schwabe, 2001

²⁵ The Human Sciences Research Council (HSRC) in collaboration with Mr Andrew Whiteford, a South African economist, has generated these estimates.

5.2 Current Situation

In late 2006 the United Nations Human Development Report was released in South Africa. For South Africa, the report shows that 13 years after the new democracy poverty still remains a burning issue. From GEAR to ASGISA (1997-2006) the divide between the rich and the poor continues to increase as the poor get poorer and as the number of households living below the poverty line increases. The Human Development Index used to measure the average progress of a country in human development, (HPI-1), focuses on the proportion of people below a threshold level in the same dimensions of human development as the human development index – living a long and healthy life, having access to education, and a decent standard of living. By looking beyond income deprivation, the HPI-1 represents a multi-dimensional alternative to the \$1 a day (PPP US\$) poverty measure.²⁶ The UNDP HDR report for 2006 states the HPI-1 value for South Africa as 30.9, which ranks South Africa 53rd among 102 developing countries for which the index has been calculated.

On the UNDP Human Development Index, South Africa ranks 53rd among 102 developing countries

South Africa's Gender-related Development Index (GDI) value of 0.646 compared to its HDI value of 0.653 indicates that the poverty situation for women, on average, is worse than for men. Out of the 136 countries with both HDI and GDI values, 83 countries have a better ratio than South Africa.

²⁶ UNDP Report 2006

Selected indicators of human poverty for South Africa in 2004					
Human Poverty Index (HPI-1)	Probability of not surviving past age 40 (%)	Adult illiteracy rate (%ages 15 and older)	People without access to an improved water source (%)	Children underweight for age (% ages 0-5)	
1. Uruguay (3.3)	1. Hong Kong, China (SAR) (1.5)	1. Cuba (0.2)	1. Bulgaria (1)	1. Chile (1)	
51. Congo (27.9)	150. Côte d'Ivoire (42.3)	68. Namibia (15.0)	44. Samoa (Western) (12)	56. Iran, Islamic Rep. of (11)	
52. Djibouti (30.0)	151. Guinea-Bissau (42.9)	69. Mauritius (15.6)	45. Seychelles (12)	57. Malaysia (11)	
53. South Africa (30.9)	152. South Africa (43.3)	70. South Africa (17.6)	46. South Africa (12)	58. South Africa (12)	
54. Sudan (31.3)	153. Cameroon (43.9)	71. Lesotho (17.8)	47. Namibia (13)	59. Turkmenistan (12)	
55. India (31.3)	154. Tanzania, U. Rep. of (44.4)	72. Oman (18.6)	48. Honduras (13)	60. Ecuador (12)	
102. Mali (60.2)	172. Swaziland (74.3)	117. Mali (81.0)	125. Ethiopia (78)	134. Nepal (48)	



5.3 The poor and access to basic services

In 2000, the President announced that all South Africans were to receive free basic services as part of government's anti-poverty drive and to counter deficiencies in the Growth, Employment and Redistribution (GEAR) macro-economic policy. In 2001, the Minister of Water Affairs and Forestry announced the Free Basic Water (FBW) policy²⁷.


 The Minister of Water Affairs and Forestry announced the Free Basic Water Policy in 2001


The threshold level of basic access to water has been defined as 6kl per household per month. It must be potable water, from a secure resource, within 200 meters and with a secure flow of a minimum of 10 litres per minute. Basic sanitation is defined as a clean, safe, healthy, environmentally acceptable and appropriate form of sanitation. Initially it could be dry sanitation or a wet/dry mix with associated implications.

Despite the good intentions of this policy and the political commitment, South Africa faces difficulties in meeting its targets of eliminating the service delivery backlog for basic water supply and basic sanitation supply by 2008 and 2010 respectively²⁸. Moreover more and more people are sliding into abject poverty thus requiring subsidies from the state (e.g. in the


 By 2006, 83% of South Africans had access to potable water supplies


form of the indigent policy, child support grants, etc.). Since the household income is so low, municipalities have to bear the cost of delivering services to a large extent, as households are not able to pay for them. Many municipalities faced with this challenge have indicated that they are finding it hard enough to cope as it is, let alone achieving the MDGs.

SOUTH AFRICAN PROGRESS WITH POTABLE WATER SERVICES

	1994	2001	2006
% of population with access to water	59%	71%	83%
Backlog	41%	29%	17%

²⁷ DWAF, FBW policy, July 2001
²⁸ van Zyl (DWAF), personal communication, 2006

It is important to point out that the figures only reflect infrastructure delivery. At the same time there remains what are called “management backlogs”, meaning that water is actually not being provided for various reasons, despite the infrastructure being there. Whereas South Africa has achieved the international MDG target for water services provision, water supply infrastructure development will have to be substantially increased in order to meet its own 2008 target. For sanitation services the situation is even more challenging.

Availability of infrastructure does not necessarily mean access to services

The above section illustrates that poverty continues to be a challenge for South Africa. Providing poor households with basic water and sanitation services is a substantial component of poverty alleviation and the South African government undertakes great efforts to address the current backlogs. The high number of poor households in the country and their inability to pay for basic services is a challenge that needs to be reflected in the foreseen regulatory framework for water services provision in the country.

CHAPTER 6

6 BACKGROUND LEGISLATION ANALYSIS

The purpose of this section is to provide the legislative context within which regulation in South Africa must operate.

6.1 The South African Constitution

This section reviews the Constitutional provisions that guide the nature and type of regulation that could be applied in South Africa.

The Constitution is the supreme law of South Africa and law or conduct inconsistent with it is invalid (section 2). It seeks to establish a society based on democratic values, social justice and fundamental human rights and to lay the foundations for a democratic and open society in which government is based on the will of the people²⁹. Section 1 requires accountability, responsiveness and openness.

The Constitution confers an inalienable right of access to **water**

6.1.1 Bill of Rights (Chapter 2)

The Bill of Rights confers inalienable rights on persons in South Africa. Section 27 is pertinent:

27. (1) *everyone has the right to have access to-*

(a)

(b) *Sufficient food and **water**; and*

(c)

(2) *The state must take reasonable legislative and other measures within its available resources, to achieve the progressive realisation of each of these rights*

6.1.2 Functions of the spheres of government

Section 40 constitutes government as national, provincial and local spheres that are distinctive, interdependent and interrelated. It is noteworthy that the Constitution uses no phrases such as “level of government” or other that denotes a hierarchy.

²⁹ Constitution of South Africa. Act 108 of 1996. Preamble.

The separation of functions between national and provincial government is structured around two of the schedules to the Constitution, namely:

- Schedule 4: Functional areas of **concurrent** national and provincial legislative competence; and
- Schedule 5: Functional areas of **exclusive** provincial legislative competence.

Local government has the executive authority and the right to administer water and sanitation services

“Water and sanitation services limited to potable water supply systems and domestic waste-water and sewage disposal systems”, is listed in Part B of Schedule 4. This means in terms of section 156(1) that local government has the executive authority and the right to administer this function. Sections 155(6) (a) and 7 however, provide that national and provincial government must through legislative or other

measures support, promote development of capacity and **regulate** the exercise of executive authority by local government. Moreover section 139 empowers a provincial executive to intervene where a municipality fails to fulfil an executive obligation in terms of legislation. However, this power is counterbalanced by section 151(4), which provides that national or provincial government may not compromise or impede a municipality’s ability or right to exercise its powers or perform its functions.

6.1.3 Co-operative Government (Chapter 3)

Chapter 3 sets out a number of principles of cooperative government to which the spheres of government (and all organs of state) must adhere. Disputes must be settled by exhausting all other mechanisms before referring to the courts.

An important dimension is that, in the constitutional scheme, municipalities as the delivery institution for water and sanitation services, do not exercise their autonomy independently: they perform their functions and exercise their powers under the supervision of both national and provincial governments. According to the Department of Provincial and Local Government (dplg), supervision includes four distinct, but

The supervisory powers of national and provincial government includes **regulation**, monitoring, support and intervention

interrelated activities: **regulation**, monitoring, support and intervention³⁰. The dplg guideline expresses the limits to the regulatory power as follows:

In terms of section 155(7) of the Constitution the provinces have the power to regulate, through legislative and executive measures, the municipality's exercise of their executive authority. However, regulation should not extend to the core of Schedule 4B and 5B matters, but should rather provide a framework within which local government is to legislate on them. It cannot determine specific outcomes of municipal legislation on these matters. The limits of provincial regulation is also emphasised in section 151(4) of the Constitution, which provides that a provincial government may not compromise or impede a municipality's ability or right to exercise its powers or perform its functions . This provision is concerned with the way provincial power is exercised, not with whether or not a power exists. Provincial legislation that over-regulates, or establishes monitoring provisions that place unreasonable strain on municipalities, are examples of legislation that compromises or impedes a municipality's ability or right to exercise its powers or perform its functions. Another example is regulation that effectively deprives local government of the ability to make any policy choices on Schedules 4B and 5B matters.

6.1.4 Public Administration

Section 195 elaborates on the basic values and principles that govern public administration. It sets the tone for the interaction between public officials and the public, insisting on high professional ethics, efficiency, effectiveness, impartiality, accountability and transparency.

6.2 Local Government Legislation

Local government is the major mechanism for the delivery of water services and is primarily regulated through the suite of legislation administered by the Department of Provincial and Local Government (dplg). Local government as water services authorities and generally as water services providers (in terms of the Water Services Act, see below) would be the object of any sectoral regulatory initiative. This legislation review is intended only to highlight the more important features and to demonstrate that water services

Local government, as service providers, is primarily regulated through the suite of legislation administered by the dplg

³⁰ Department of Provincial and Local Government. A guideline document on provincial-local intergovernmental relations. 2003.

are delivered within a comprehensive regulatory system of legislation, regulations and policy. Any water sector regulatory initiative will have to accommodate this complexity.

6.2.1 Municipal Structures Act³¹

The Municipal Structures Act legislates for the structure of local government in the country. It defines the three categories namely metropolitan, district and local and the types of municipalities and their creation.

6.2.2 Municipal Systems Act³²

The Municipal Systems Act sets out the core principles, mechanisms and processes that give meaning to developmental local government and seeks to empower municipalities to move progressively towards the social and economic upliftment of communities and the provision of basic services.

Chapter 4 deals with community participation, a key feature of developmental regulation. Section 16 obliges a municipality to develop “*a culture of municipal governance that complements formal representative government with a system of participatory governance*”.

Chapter 5 is central to water services as it is the chapter that requires the preparation and adoption of Integrated Development Plans (IDPs) of which the water services development plans that are required by the Water Services Act (see below), form a part. Sections 23 to 25 set out the general principles of IDPs namely that they are development orientated and prepared in the context of co-operative government.

—————
IDPs are central to the
planning of service delivery
in municipality
—————

Chapter 7 is concerned with the administration of local government. It seeks to establish a culture of service that inter alia, sets as requirements responsiveness to the needs of the local community, a culture of public service and accountability amongst its staff, performance orientation and focus on the objects of local government, etc. In pro-poor regulation, access to a responsive bureaucracy is a key element.

Chapter 8 deals with the provision of services. Section 73 requires:

*73. (1) A municipality must give effect to the provisions of the Constitution and—
(a) Give priority to the basic needs of the local community;*

³¹ Act No 117 of 1998, amended in 1999, 2000 and 2002

³² Act No 32 of 2000, amended in 2003

- (b) Promote the development of the local community; and*
- (c) Ensure that all members of the local community have access to at least the minimum level of basic municipal services.*

The section goes on to list the principles of service delivery as being equitable and accessible; prudent, economic, efficient and effective use of available resources; financially sustainable; and environmentally sustainable. The chapter also includes detailed requirements on service tariffs, delivery mechanisms, service agreements, competitive bidding and the establishment of internal and multi-jurisdictional municipal service districts.

6.3 Financial Management Legislation

A brief review of financial management legislation is provided here because the finances of the institutions concerned with water services delivery is an important element of any regulatory system.

6.3.1 Public Finance Management Act (PFMA)³³

The object of the PFMA is to secure transparency, accountability and sound management of the revenue, expenditure, assets and liabilities of the institutions to which it applies (section 2). From a regulation perspective the PFMA ensures that the finances of water entities that fall under the Act are prepared in standard ways and are open and transparent. It places accountability for sound financial management firmly with the controlling structures of the entity.

6.3.2 Municipal Finance Management Act (MFMA)³⁴

The MFMA applies to all local government and hence to all water service authorities. The object of this Act is to secure sound and sustainable management of and municipal entities by establishing norms and standards and other requirements. A key characteristic from a water

The MFMA establishes norms and standards for the fiscal and financial affairs of municipalities including budgeting

regulatory perspective is transparent financial reporting requirements according to **generally recognised accounting practice** prescribed in terms of section 91(1) (b) of the Public Finance Management Act (see above). This will facilitate benchmarking and provide accurate financial information for tariff determinations.

³³ Act No 1 of 1999, amended in 1999

³⁴ Act No 56 of 2003

6.4 Legislation for independent regulation in other Sectors

South Africa has several pieces of legislation that deal with independent regulation, including of utilities. These are dealt with in this report in the section on other sector regulators.

6.5 Water Sector Legislation

6.5.1 National Water Act, Act 36 of 1998 (NWA)

The purpose of the NWA (as specified in Section 2) is to ensure that the nation's water resources are protected, used, developed, conserved, managed and controlled in ways which take into account a list of factors. The NWA is directed at resource management and a detailed review is thus outside the scope of this study.

6.5.2 Water Services Act (Act 108 of 1997) (WSA)

The Water Services Act provides the “rules” for the operation of water and sanitation services

The object of the WSA is to legislate for the supply of potable water and sanitation services. In particular, it provides for the Constitutional right to have access to sufficient water and an environment that is not harmful to health and well-being. It extends this right to mean a right of access to a basic supply of water and basic sanitation.

The WSA is the legislative basis for regulation in the water and sanitation services sector. It provides the “rules” for the operation of water and sanitation services. It sets a number of requirements directly on water service authorities, the principal of which are:

- Progressive extension of services to all;
- Priority for basic services;
- Preparation of Water Services Development Plans;
- The making of bye-laws;
- The conditions under which services can be limited or discontinued;
- The appointment of water services providers; and
- The provision of information.

In addition, the WSA structures the water boards and other sector institutions and empowers the Minister to make **regulations** on a number of matters for the purpose of achieving national consistency. Regulations have been promulgated for standards (section 9)³⁵, tariffs

³⁵ Regulations relating to compulsory national standards and measures to conserve water. GN R 509. GG22355. 8 June 2001.

(section 10)³⁶ and water service contracts (section 19)³⁷. The reader is referred to the report of a separate study³⁸ for a detailed section-by-section exposition of the WSA regulatory provisions.

From a regulatory perspective the Act requires the Minister and any relevant province to monitor the **compliance** of water services institutions (section 62).

To this end the water services institution must provide any requested information.

If a water services authority has not effectively performed any function imposed on it by or under the Act, the Minister of Water Affairs and Forestry may, in consultation with the Minister for Provincial and Local Government, request the relevant Province to intervene in terms of section 139 of the Constitution. If this fails to materialise the Minister may intervene and assume the responsibility for the function (section 63).

Of relevance to any future establishment of an independent regulator is that the Minister has the authority (section 74) to delegate any power vested in him or her by or under the Act except those to make regulations; to issue directives under section 41; to intervene under section 63; to appoint members of a water board; to prescribe policy; or to expropriate.

The WSA does not provide for a licensing mechanism that is one of the characteristic mechanisms used in independent regulatory systems. The water services authority coincides with the local government authority established in terms of the Constitution and the Local Government: Municipal Structures Act. Where the water services authority is not itself the water services provider, the authority contracts in a provider. The authority of a water board and its area of operation are established by way of Ministerial notice in terms of the Water Services Act.

Regulations have been promulgated for:

Standards;
Tariffs; and
Water service contracts

Water boards are not part of the local government system. Their financial affairs are regulated by the PFMA and not the MFMA.

³⁶ Norms and standards in respect of tariffs for water services in terms of section 10 (1) of the Water Services Act (Act no. 108 of 1997) GN. R. 652. GG22472. 20 July 2001.

³⁷ Water services provider contract regulations. GNR 980. GG 23636. 19 July 2002

³⁸ Palmer Development Group. Policy, Legislation and International Literature Review. Investigating the Water Services Sector's Readiness in the Context of Regulation. DWAF. February 2005.

6.6 Conclusion on Legislative Framework

6.6.1 The Regulator

The basic legislative framework for the regulation of water services already exists. If the paradigm is for the Department of Water Affairs and Forestry (DWAF) to be the “national regulator” as envisaged in the DWAF policy documents (see separate analysis), then no further legislative action will be necessary. As the function is developed within DWAF, the Minister is empowered to make regulations for any aspects that may become necessary.

The basic legislative framework for the regulation of water services already exists but new legislation should be enacted if an independent regulator is established

The conclusion is different if an independent regulator is to be established. In terms of the WSA, the Minister could delegate the powers necessary to an independent regulator. However, such a course, using subsidiary legislation, would inevitably raise questions about the institutional nature of the regulator and more importantly about its independence. It would thus seem expeditious to follow the example in other sectors and have the regulator’s establishment provided for in specific legislation or by amendment to the WSA. The limits of the powers and functions that could be assigned to an independent regulator are only determined by the Constitutional provisions related to the autonomy of the local sphere of government (see above).

6.6.2 Pro-poor Regulation

The Constitutional provision of a right of access to sufficient water is profoundly pro-poor. It is given effect to in various measures in the legislation and subsidiary regulations for local government and the water sector. Perhaps the most important thread is the authority to differentiate between users on the applicability of measures for the purpose of eliminating poverty. These provisions are backed up by the systems requiring transparency, responsibility and accountability in municipal financial practice.

The legislative framework is pro-poor

6.6.3 Legislative and policy misalignments

A recent study³⁹ shows that there are a number of instances where legislation places potentially conflicting requirements on the municipality. This refers principally to the WSA, Municipal Systems Act and the Municipal Finance Management Act. For a departmental regulator, the overlaps in jurisdiction between, for example, the role of the Department of Health in potable water quality can be resolved by an ongoing process in terms of the Inter-governmental Relations Act. For an independent regulator, this will have to be resolved before its establishment legislation is enacted.

³⁹ DWAF (Palmer Development Group). Investigating the Water Services Sector's Readiness in the Context of Regulation, Including Needs, Priorities and Challenges with Particular Emphasis on DWAF and Local Government. Output 1: Policy, Legislation and International Literature Review. February 2005

CHAPTER 7

7 BACKGROUND POLICY ANALYSIS

The purpose of this section is to identify in the formal and informal policy of government those policies that refer to regulation and the treatment of the poor.

7.1 White Paper on Reconstruction and Development (RDP)⁴⁰

The White Paper was published shortly after the transition to democratic government. The core policy *“is a commitment to effectively address the problems of poverty and the gross inequality evident in almost all aspects of South African society”*. It explicitly recognises the link between reconstruction and development and economic growth.

7.2 Growth, Employment and Redistribution (GEAR)⁴¹

Gear is unashamedly a **macro** economic policy for rebuilding and restructuring the economy. It has been criticized for ignoring the poor. Nevertheless, it includes in its vision statement the redistribution of income and opportunities in favour of the poor and services being available to all. It also purports to be consistent with the goals of the RDP and, within the context of the integrated economic strategy, to confront the related challenges of meeting basic needs.

7.3 Accelerated and Shared Growth Initiative of South Africa (ASGISA)

The Deputy State President launched ASGISA on 6 February 2006⁴². It has the ultimate objective to halve unemployment and poverty by 2014 (reducing unemployment to below 15% and halving the poverty rate to less than one-sixth of households). It does not purport to be a comprehensive economic policy and it does not replace the Growth Employment and Redistribution (GEAR) strategy. It consists of a limited set of interventions at micro-economic level that are intended to serve as catalysts.

The extent to which ASGISA is actually “pro-poor” (i.e. will achieve redistribution) has not gone unchallenged. The Congress of South African Trade Unions (Cosatu) has been

⁴⁰ Republic of South Africa. 15 November 1994

⁴¹ Republic of South Africa. Growth, Employment and Redistribution: A Macroeconomic Strategy 14 June 1996

⁴² Republic of South Africa. Parliamentary media briefing by Deputy State President. 2 February 2006. www.info.gov.za

quoted⁴³ as saying it could only support the strategy if agreement was reached for it to be redesigned “*to ensure that our common commitment to shared rather than inequitable growth runs through all its programmes*”. The conclusion for the purposes of this research is that other than the objective of equitable distribution of the benefits of economic growth, ASGISA provides little assistance for structuring pro-poor regulation.

7.4 The White Paper on Local Government⁴⁴

The Constitution envisages a complete transformation of the local government system. This was legislated for in the Local Government Transition Act of 1993.

This White Paper emphasises the role of local government as a sphere of government in its own right rather than a function of national or provincial government. This role is in the building of democracy and the promoting of socio-economic development. In the context of this research, the key concept to this

The White Paper on Local Government requires that local government must focus on the delivery of affordable and sustainable services

end is “*developmental local government*” that works with communities to “*create sustainable human settlements which provide for a decent quality of life and meet the social, economic and material needs of communities in a holistic way*”. It recommends that municipalities look for innovative ways of providing and accelerating the delivery of municipal services. The White Paper puts it that local government must focus their own institutional and financial capacity on the delivery of affordable and sustainable services relevant to the needs of local communities. This is a decidedly pro-poor stance.

7.5 The White Paper on Municipal Service Partnerships⁴⁵

This White Paper starts from the premise that on its own local government will take an inordinate time to deliver acceptable services to all. Building on the concepts of partnerships the White Paper seeks to provide a framework within which local government can partner with other public institutions, the private sector, Community Based Organisations (CBOs) and Non Governmental Organisations (NGOs) towards meeting the objectives of developmental local government.

⁴³ City Press, Johannesburg, 19 February 2006

⁴⁴ Republic of South Africa. White Paper on Local Government. 1998

⁴⁵ Republic of South Africa. White Paper on Municipal Service Partnerships. 2004.

7.6 White Paper on Water Supply and Sanitation Policy⁴⁶

This white paper was published shortly after the transition to democratic government. The focus on water supply and sanitation services among the many functions of DWAF, reflected the absence of coherent policy in this area and the high priority given to them by the then Government of National Unity.

The White Paper points out that the national government's role in water and sanitation services is **indirect** but strongly states that it must be able to comply with the constitutional obligation to ensure that every South African has access to sufficient water. *"This requires the capacity to establish national policy guidelines, a national water and sanitation development strategy, the formulation of criteria for State subsidies, the setting of minimum services standards as well as monitoring and **regulating** service provision"*. The White Paper speaks of DWAF as the "regulator"⁴⁷.

7.7 White Paper on National Sanitation Policy⁴⁸

This White Paper builds on the Water and Sanitation Policy that is described above. In the opening paragraphs it states that it addresses *"the needs and wishes of ordinary people, particularly their desire for healthy living conditions. It is also concerned with those issues which can affect the delivery of services, especially the economy and the environment"*.

7.8 White Paper on a National Water Policy for South Africa⁴⁹

This white paper addresses water resources management in South Africa and falls largely outside the ambit of this research. Nevertheless it is noted because it establishes the principles that led to the later creation of the "Reserve" in the National Water Act⁵⁰. The Reserve provides that before any other claims on a water resource are considered, sufficient amounts of water must be set aside to satisfy basic human needs.

7.9 White Paper on Basic Household Sanitation, 2001

As with the White Paper of 1994, this White Paper reiterates that the main implementing agencies or service providers are at local government level while one of the generic roles and responsibilities of national government is to **regulate** service provision. It is noted that regulations published under the Water Services Act, 1997 prescribed that a tariff set by a water services institution for the provision of sanitation services to a household must support

⁴⁶ Republic of South Africa. White Paper on Water and Sanitation Policy. November, 1994.

⁴⁷ *Op Cit.* See for example page 19

⁴⁸ Republic of South Africa. White Paper on National Sanitation Policy, October 1996

⁴⁹ Republic of South Africa. April 1997.

⁵⁰ Act 36 of 1998.

the viability and sustainability of sanitation services to the poor. While cost recovery and cross subsidisation is identified in many areas as a matter that must receive urgent attention, government policy requires that the very poor be given access to a free basic level of service⁵¹.

7.10 Towards a Water Services White Paper⁵²

In 2002, DWAF issued an “*Issues and Options Discussion Paper*” with the above title. The paper emphasises how dynamic the policy milieu had become since the White Paper in 1994. Moreover with the restructuring of local government having been completed and that sphere of government due

DWAF envisages its role as changing “*from a direct provider to that of a sector leader, supporter and regulator*”

to take up its Constitutional role of provider of services, DWAF envisaged its role as changing “*from a direct provider to that of a sector leader, supporter and regulator*”⁵³.

Although the paper expressly states that it is a consultation paper rather than a policy document, it does reinforce a series of policy positions that had been adopted or changed through means other than a White Paper. Foremost among these and of particular interest to this study was the Free Basic Water Policy. Whereas the 1994 White Paper had said that every user must contribute at least the operational cost of delivering water services, the new policy, announced by the Minister, required all water services authorities to ensure that every poor household received the first 6kl/month free.

The paper devotes a chapter to the issue of regulation. The approach taken implies a broad definition in which regulation is taken to mean any mechanism in which a service provider is caused to deliver services in accordance with the intention of government. So for example DWAF is referred to as the “national regulator” while local government is referred to as the “local regulator”. The role of byelaws is emphasised as an important regulatory mechanism at local level.

The Paper describes the purpose of regulation as⁵⁴:

- “To ensure provision of basic services (especially the extension of services to the poor);

⁵¹ *Op Cit.* Page 30

⁵² Department of Water Affairs and Forestry. April 2002

⁵³ *Op Cit.* Page 1

⁵⁴ *Op Cit* Para 6.4.2

- To ensure effective water services institutions (WSIs);
- To ensure the efficiency and sustainability of water services to underpin economic and social development;
- To protect consumers from excessive charges and poor service;
- To encourage investment in the sector and thereby also to contribute to building the economy and creating jobs”.

With the very broad approach taken to “regulation” and the national department remaining as the “regulator”, the proposals dissolve into little more than “government as usual”, even if the function is to be fully developed within DWAF⁵⁵. The Paper mentions the possibility of an independent regulator but merely states that the option may **have** to be considered in the long-term when circumstances demand it but in the meantime DWAF will act as regulator. This approach is at variance with the dominant international concept of a regulator as an independent institution that is part of the governance system and that is separate from the roles of policy maker and operator⁵⁶.

Although the stated intention of the issues and options discussion paper was as preparation for a new White Paper on water and sanitation, government decided not to proceed to a White Paper but rather to address strategy in the policy, legislation and strategy continuum.

7.11 Strategic Framework for Water Services⁵⁷

“The purpose of the Strategic Framework is to put forward a vision for the water services sector in South Africa for the next ten years (from 2003), and to set out the framework that will enable the sector vision to be achieved.”

The Strategic Framework:

- Describes the challenges in the water sector;
- Sets the sector vision, goals and targets;
- Outlines existing and intended sub-frameworks for:
 - ▣ Institutional reform;
 - ▣ Planning;
 - ▣ National norms and standards
 - ▣ Financial;
 - ▣ **Regulation;** and

⁵⁵ Op cit. Para 6.4.7

⁵⁶ SOWAS – Working group on Regulation and PSP in Sub-Saharan Africa. Sharing the Experience on Regulation in the Water Sector. GTZ April 2004. p8.

⁵⁷ Department of Water Affairs and Forestry. September 2003.

- Support and monitoring.

The Strategic Framework introduces the concept of the “water ladder”. This states unequivocally that the provision of a basic water and sanitation service to all **is the most important policy priority**. The government commits to making adequate funds available over the next few years in order to achieve this priority. The following step on the “ladder” is an intermediate level service and so on.

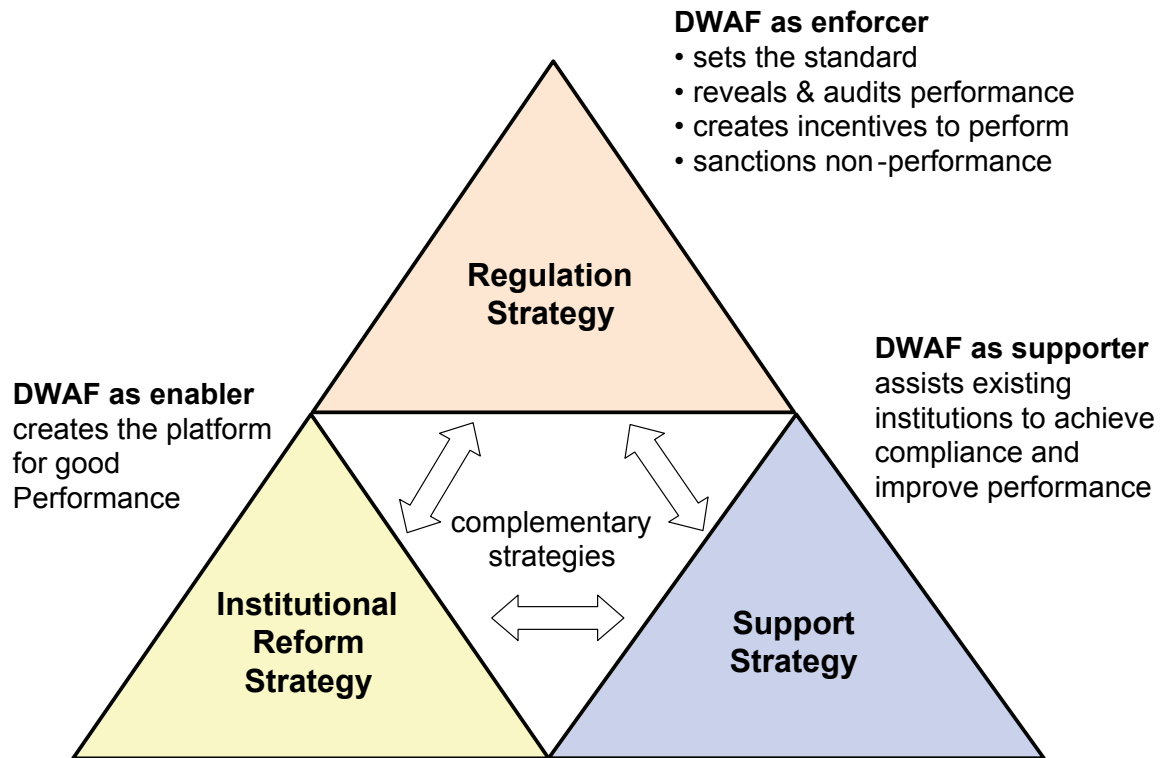
The Strategic Framework firstly sets out the sector vision and goals. These are then developed into 19 sector targets. The emphasis on universal coverage, affordability and health education all provide a strong “pro-poor” thrust.

As far as regulation is concerned the Framework develops a sub-framework for regulation in its chapter 7. The approach to a “regulatory framework” is very wide. It designates DWAF as the national regulator and water services authorities as the local regulator and other departments and sector institutions as also fulfilling a regulatory role. While acknowledging the autonomy of the local government as a sphere of government, it places emphasis on matters of compliance and the circumstances in which national government will intervene (see for example paragraph 7.3.2). In each of the sub-frameworks for planning, financial and norms and standards, the Framework envisages strong regulatory, compliance monitoring and interventionist functions for DWAF. As far as independent regulation is concerned, the Framework states merely that its efficacy will be assessed.

7.12 Draft National Water Services Regulation Strategy⁵⁸

The draft Regulation Strategy is one of the outcomes of the Strategic Framework for Water Services. It is depicted as one of a trilogy of strategies in the diagram below:

⁵⁸ This analysis is based on Draft 3.03 of October 2005



The Strategy departs from the proposition that the primary purpose of regulation is the protection of the consumer. This is immediately elaborated by the statement that in the long term, the sustainability of service providers is in the consumer's interest. The purpose is achieved through the pursuit of objectives in each of the categories of "social regulation" (achieving universal access), public health or drinking water quality regulation, environmental (or water resources) regulation, and economic regulation (the regulation of the providers of infrastructure services in terms of quality of service and price).

The Strategy has two components. The first is to create the conditions for effective regulation through understanding performance and creating an enabling environment. The second component is to implement regulation strategically in the four categories of regulation listed in the previous paragraph.

There is an acknowledgement that not all aspects of a water service can be monitored. As an interim measure the Strategy proposes nine priority indicators as shown in the box below:

Performance indicators contained in the strategic framework:

1. Access to basic water supply
2. Access to basic sanitation supply
3. Quality of services: Potable water quality
4. Quality of services: Continuity of supply
5. Access to free basic services (water)
6. Access to free basic services (sanitation)
7. Financial performance: Affordability and debtor management
8. Asset management: Metering coverage and unaccounted-for water
9. Protection of the environment: Effluent discharge quality

The Strategy proposes the development of consumer voice as an important process for assisting DWAF and local regulators in identifying deficiencies in service providers. Consumer voice is widely recognised as an important element in pro-poor regulation.

The Strategy devotes a chapter to developing strong enforcement mechanisms in line with the interventionist approach evident in the Strategic Framework for Water Services. It is also a broad approach to regulation where even the pressure by local government councillors to keep water tariffs low is regarded as a form of regulation (Para 10.5.2). It is in the discussion of an intervention protocol (Para 6.3) where the complimentary nature of the trilogy of strategies is challenged. Here it is said that, in response to non-compliance, *“it is not the task of the regulator to support or directly intervene”*. Yet this is precisely what DWAF would have to do in terms of its support and enabling strategies. **It is precisely on this point that the compatibility of support and regulation within a single institution will be challenged.**

The Strategy goes into detail on how the above four categories of regulation will be implemented. The Strategy follows the Strategic Framework for Water Services on the point of the institution of an independent regulator and does not explore the issue. In fact it sees DWAF’s dominant role in the **long term** will be as sector leader and regulator (Para 1.5).

7.13 Conclusion on the Policy Framework

7.13.1 Pro-poor Regulation

All of the policy measures lay emphasis on the Constitutional imperative of progressively providing access to sufficient water for all. Other elements of pro-poor regulation are also present such as affordability and consumer voice.

7.13.2 The Regulator

The current DWAF policy is that DWAF itself will be the national regulator of the water sector for the foreseeable future. Other government structures are described as fulfilling regulatory roles. The DWAF proposals envisage classical government regulation.

Independent regulation has not been evaluated and the strategy proposals do not envisage significant growth in participation by the private sector in the water sector and hence any need for new regulatory models. This presents some discord with other sectors for example in local government where public private municipal partnerships are equal candidates for mechanisms to extend services.

CHAPTER 8

8 INSTITUTIONAL ANALYSIS

In the following overview the organisational components of water management institutions are analysed in terms of the implications of water services regulation. The basis for this analysis is the various pieces of legislation dealing with the formation, management and oversight of water management and water services organisations in the country.

The South African Constitution allows national government (DWA) to decentralize its power and attendant responsibilities to municipalities or other water service authorities in keeping with the subsidiary principle inherent to IWRM. In this way, local government can assume the responsibility for the provision of water services and can contract with private companies to manage and provide water services. However – the national government, “bears the ultimate responsibility to ensure compliance with the state’s obligations” – as contained in the Bill of Rights of the Constitution⁵⁹.

8.1 Water Service Institutions

The South African water sector is governed by two central pieces of legislation, namely the Water Services Act (No.108 of 1997) (WSA) and the National Water Act (No.36 of 1998) (NWA). The Water Services Act serves as a framework for monitoring and regulating various institutions that play a role in water services provision and the National Water Act sets out the requirements in terms of the conservation of water resources and the efficient use thereof.

8.1.1 The Department of Water Affairs and Forestry

According to the NWA, as the public trustee of the nation's water resources, the National Government, acting through the Minister, must ensure that water is protected, used, developed, conserved, managed and controlled in a sustainable and equitable manner. The Minister has delegated many of his powers and functions to DWA.

National Government is the public trustee of the nation's water resources

⁵⁹ Welch, A.R. 2005. Obligations of State and Non-State Actors Regarding the Human Right to Water Under the South African Constitution. In *Sustainable Development Law and Policy Journal* 5:1. American University, Washington D.C. p60

DWAF is the national department, which carries the authority over the sector that is assigned by the Constitution to the executive. It is responsible, through the Minister, for the development of the legislative framework governing the water sector and administers the National Water Act and the Water Services Act.

As noted in the legislation analysis above, water and sanitation services are an area of concurrent national and provincial legislative authority and local government has the executive authority and the right to administer this function. Section 156 of the Constitution obliges national government through legislative and other means to support local government. The Water Services Act and DWAF’s administration of it, is a manifestation of this. Through the mechanism of the WSA and regulations promulgated in terms thereof, DWAF regulates water services nationally.

During the political transition, DWAF acquired the water supply assets of the old homeland governments and is in the last phases of transferring these to local governments.

8.1.2 Water Services Authorities

Water service authorities are defined in the WSA as “any municipality, including a district or rural council ... responsible for ensuring access to water services”. It is the duty of each water services authority to ensure that current consumers, as well as prospective consumers, within their area of jurisdiction, have efficient, cost-effective, reasonably priced and sustainable access to water services. Following procedures prescribed by the Municipal Systems Act a municipality may choose to provide water services themselves or can enter into a contract with a water service provider to supply water services. The ability of a water services authority to carry out its

The municipality is *ipso jure* the water services authority

A municipality may provide water services itself or it can enter into a contract with a water service provider to supply the services

responsibilities is subject to a number of factors including, the availability of resources, the need for equitable allocation of resources, the need to regulate equitably access to water services and the duty to conserve resources, amongst others. The WSA sets out the rights and duties of consumers and places emphasis on ensuring the financial viability of water service providers.

Each water services authority is required to formulate a water services development plan as part of its broader integrated development plan. This plan must be developed in conjunction with the Catchment Management Strategy formulated

by the Catchment Management Agency (CMA) (see below) in that specific Water Management Area (WMA).

Water services authorities have the power to execute the functions of a water services provider and they also have the option of engaging in a joint venture with another water services institution for the purposes of water service provision. However, when a water services authority performs the functions of a water services provider for another authority, it must administer and report those functions separately.

8.1.3 Water Services Providers

According to the Water Services Act, a water services provider is a public or private entity that supplies water services to consumers or to other water services institutions.

In terms of the WSA, water services providers may only operate upon approval by a water services authority within a specific area of jurisdiction in which the service is to be provided. It is therefore the duty of the water services authority to monitor the performance of the water services providers and to ensure compliance with contractual agreements and to promulgated norms and standards.

8.1.4 Water Boards

Water boards are bodies corporate with all the powers of a natural person except those that by their nature can only attach to a natural person or which are inconsistent with the WSA. Their powers, activities and duties are relatively widely defined. The main function of a water board is to supply water services to other water services bodies within its demarcated service area. It is required to provide its services in terms of a contract. A water board may take on additional water functions provided that these will not be detrimental to its primary function or own financial standing. A water board is not part of local government.

Water boards are bodies corporate and not part of local government

A water board operates in terms of two central instruments, namely a **policy statement** (section 39) that must be accessible to the public and a **business plan** (section 40) that may exclude sensitive commercial information and for which there is no requirement for public access. Oversight is provided as the water board must submit both these instruments to the Minister and she may direct that they be amended. Other governance measures are that the board must report annually on its activities (section 44) and its financial statements must be

audited against generally accepted accounting practice (section 43). The Minister may investigate the affairs and financial position of any water board (section 45).

8.2 Other related water sector institutions

8.2.1 Catchment Management Agencies (CMA)

According to the National Water Act, the purpose of establishing a CMA is to entrust water resource management to the local level and thereby ensure community participation. The first CMAs were recently established. A CMA is an organ of state and as a body corporate, has the powers of a natural person of full capacity, except those powers which (a) by nature can only attach to natural persons or (b) are inconsistent with the NWA. CMAs are established for a specified water management area after a process of public consultation, based on proposals by the public. In the event of a CMA not being established for a specific water management area, the Minister serves as the CMA.

When established the CMA has the basic powers listed in the NWA. These relate mainly to the establishment of a catchment management strategy. The Minister may delegate further powers as the institutional capacity of CMAs increases. Ultimately, CMAs can be granted the powers to regulate water resources including the granting of licences. Their influence on water services regulation will lie at the interface between water resources management and water services management.

8.2.2 Water User Associations

Water user associations operate at a restricted localised level, and are in effect co-operative associations of individual water users who wish to undertake water-related activities for their mutual benefit. A water user association may exercise management powers and duties only if and to the extent these have been assigned or delegated to it. The Minister establishes and disestablishes water user associations according to procedures set out in the National Water Act, usually following a proposal to the Minister by an interested person, but such an association may also be established on the Minister's initiative. The functions of a water user association depend on its approved constitution, which can be expected to conform to a large extent to the model constitution provided by the NWA. The Minister may exercise control over WUAs by giving them directives or by temporarily taking over their functions under particular circumstances. Existing irrigation boards, subterranean water control boards and water boards established for stock watering purposes will continue in operation until they are restructured as water user associations.

Water user associations have little bearing on water services regulation.

8.3 Other Institutions

8.3.1 The Department of Provincial and Local Government (dplg)

The dplg's mandate is derived from Chapters 3 and 7 of the Constitution. As a national department its main function is to develop national policies and legislation with regard to provinces and local government, and to monitor the implementation of a number of acts, the

most relevant for water services regulation being the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) and the Municipal Finance Management Act, 2003. The White Paper on Local Government (1998) and the White Paper on Municipal Partnerships, expresses the government's policy.

The dplg's other function is to support Provinces and Local Government in fulfilling their constitutional and legal obligations. These obligations, as noted, above include delivery of water and sanitation services.

With DWAF having national responsibilities for water and sanitation services and interacting directly with local government on sector issues and the dplg having responsibilities for local

government matters and acting largely through the provinces, the tenets of the Constitutional imperative of cooperative government are at times challenged.

8.3.2 Municipalities

In terms of the Constitution, local government has the executive authority and the right to administer water and sanitation services. In Chapter 7, it sets out the roles and responsibilities of municipalities in terms of service delivery. Chapter 8 of the Municipal Systems Act (No. 32 of 2000) stipulates the basic duties of municipalities which includes giving priority to the

basic needs of the local community, promoting the development of the local community and ensuring access to the minimum level of basic municipal services.

A municipality is also required, in terms of the Municipal Systems Act, to devise an integrated development plan (IDP) which serves as a framework for its service delivery plans. Metropolitan municipalities and either district or local municipalities are responsible for water

The dplg develops national policies and legislation with regard to provinces and local government. It has supervisory and supportive roles

The municipality must give priority to the basic needs of the local community and ensure access to the minimum level of basic municipal services

service provision in their areas of authority. Municipalities by the action of law are the water services authorities and thus have the responsibility of setting tariffs, enforcing relevant legislation and monitoring the performance of service provision. In its capacity as a service authority, a municipality is responsible for the provision of services. In terms of section 78 of the Municipal Systems Act a municipality must undertake an investigation into the mechanisms through which services will be provided. The most common outcome has been that the municipality remains as its own water services provider. However, a municipality may employ external service delivery mechanisms. As a service provider, it is the responsibility of a municipality to provide water services in an efficient and effective manner and ensure optimal consumer satisfaction with the service provided.

CHAPTER 9

9 OTHER SOUTH AFRICAN UTILITY REGULATORS

South Africa has many regulatory structures some of which are statutory and others of a private industry nature. In this section attention is drawn to those of an infrastructure nature and that which could influence regulation in the water sector.

9.1 The National Energy Regulator⁶⁰

The National Energy Regulator of South Africa (NERSA) is the regulatory authority established in terms of the National Energy Regulator Act, 2004 (Act No. 40 of 2004) with the mandate to undertake the functions of:

- the Gas Regulator as set out in the Gas Act of 2001;
- the Petroleum Pipelines Regulatory Authority as set out in the Petroleum Pipelines Act of 2003; and
- The National Electricity Regulator as set out in the Electricity Act of 1987 as amended.

The board members of the Energy Regulator are appointed by the Minister. The Act requires the members to act independently and in the public interest.

The formal functions of the Energy Regulator include licensing, the approval of tariffs and charges and the promotion of competition. The NERSA has regarded customer services as one of its core regulatory functions.

9.2 The Independent Communications Authority of South Africa (ICASA)⁶¹

ICASA is the regulator of telecommunications and broadcasting. It was established in terms of the Independent Communications Authority of South Africa Act No.13 of 2000.

The functions of ICASA include making regulations and policies that govern broadcasting and telecommunications, the issuing of licences and the protection of consumers from unfair business practices, poor quality services and harmful or inferior products.

⁶⁰ <http://www.nersa.org.za> on 10 November 2006.

⁶¹ <http://www.icasa.org.za> on 30 November 2006.

Like NERSA, ICASA places great importance on consumer education and protection. It regards itself in this regard as the “watchdog” over industry.

9.3 The Competition Commission

Jerome⁶² points out that there is a potential overlap of jurisdiction between a utilities regulator and the Competition Commission. The Competition Act gives the Commission a role in ensuring that the activities of any regulatory authority is harmonised with the Act. This relates principally to any action that might limit competition.

⁶² Jerome A. Privatisation and Regulation in South Africa – An Evaluation. 3rd International Conference on Pro-Poor Regulation and Competition: Issues, Policies and Practices, Cape Town – South Africa. 7-9 September 2004.

CHAPTER 10

10 IMPLICATIONS OF GATS COMMITMENTS

In recent times uncertainty has arisen about the possible implications of the World Trade Organisation's General Agreement on Trade in Services (GATS). One concern is that the agreement will give unfettered access to international companies for the delivery of water services thus making it difficult to impose the current regulatory, policy and legislative regime in the water services sector. This chapter examines the issues.

The concern about GATS is that it may impact on the regulatory framework and negating sector policies and approaches

10.1 Introduction

As a member of the World Trade Organisation (WTO) South Africa is bound by the General Agreements on Trade in Services (GATS). The GATS is intended to promote liberalisation in services trade and regulates measures taken by WTO Member countries that affect trade in services. As such it establishes a framework for WTO members' service providers to access services markets in other Member states. In the context of water services regulation it is important to understand the relationship between the GATS and domestic regulation, as, arguably, a country's regulatory space could be impacted by the GATS.

10.2 GATS Concepts

The objective of the GATS is to promote the liberalisation of services trade within a rules-based framework. To this end, the agreement establishes a number of key principles to which WTO Member States have to adhere. The most important ones are "market access" (Art. XVI), "national treatment" (Art. XVII) and "most-favoured-nation treatment (MFN)" (Art. II)

Gats promotes the liberalisation of services trade within a rules-based framework

10.2.1 Market access

In its market access commitments a country describes to what extent it opens up which services sectors. Commitments can, but do not necessarily have to, be made in all four modes of supply. The market access commitments are listed in a country's schedule of commitments.

10.2.2 Most-Favoured-Nation Treatment

Most Favoured Nation (MFN) treatment means that a country, which grants another country a certain trade condition (a lower tariff for goods) or access to its domestic services markets, must grant this condition to all other WTO member countries. In other words, it must not discriminate against any (WTO member) country through this mechanism.

10.2.3 National Treatment

After foreign goods or services have entered a market, they need to be treated equally to locally produced goods or services. National treatment only applies once a product, service or item of intellectual property has entered the market. Therefore, charging customs duty on an import is not a violation of national treatment, even if locally produced products are not charged an equivalent tax. Whereas the national treatment principle ensures the equal treatment of foreign and local goods and services in a market, the Most

The core concept is that once a Foreign Service provider has entered the market it must be treated equally to local service providers

Favoured Nation principle ensures that foreign goods from all WTO member countries are treated equally when entering a market. Together national treatment and MFN are the two so-called non-discrimination principles.

10.2.4 Schedule of commitments

A country's schedule of commitments spells out which market access commitments a country has made in which sectors – to which a country has “bound” itself. Where countries want to make exemptions from the MFN and National Treatment obligations of the GATS or impose specific regulatory measures, these exemptions and conditions need to be listed in detail in the country's schedule of commitments.

10.2.5 Dispute Resolution

The GATS provides for dispute resolution panels and an appeal body. Only governments have access to these mechanisms and Member States are bound by the decisions. It is argued that developing countries are at a disadvantage because they lack the capacity to make use of the mechanism for their own interests or to defend against challenges.

10.3 The coverage of the GATS

The GATS applies to “measures by Members affecting trade in services” (Art. I: 1) and applies to measures affecting services trade taken at any sphere of government, including local government. While there are ongoing negotiations over the inclusion of water and

sanitation services in the non-binding classification systems of GATS, it can hardly be denied that the operations necessary to deliver water and sanitation are “services activities” as defined and therefore that, in principle, the GATS is applicable to water and sanitation services.

10.3.1 Modes of Supply

In defining trade in services the GATS distinguishes between four modes of supply. The mode practically applicable to water services is Mode 3, which relates to a commercial presence where foreign companies set up in the receiving country.

10.3.2 The Article I: 3 (b) exemption

The GATS makes an important exemption to its generally wide coverage, which is of particular significance in the context of water services provision. Art. I: 3 (b) defines services as any service in any sector “except services supplied in the exercise of governmental authority” which it further defines as one “which is neither supplied on a commercial basis, nor in competition with one or more service suppliers”. Thus,

Services supplied in the exercise of governmental authority remain outside the GATS framework

services supplied in the exercise of governmental authority remain outside the GATS framework and there is no interface between the regulation of such services and the agreement.

The interpretation of “which is neither supplied on a commercial basis, nor in competition with one or more service suppliers” is however unclear. At present, there are no WTO panel or Appellate Body decisions resolving the matter. But it does seem clear that the GATS applies to services provided by private suppliers as well as those services that do not clearly fall under the definition of being “supplied in the exercise of governmental authority”.

10.4 GATS obligations and disciplines

The GATS does not require governments to make any commitments in any specific sector, nor does it require the privatisation or deregulation of any service.

Services offers are negotiated on a request – offer basis. A country can submit market access requests to another country, or group of countries, in which it asks to open up certain sectors of the approached country’s service market. Where the requested country responds in making an offer to open up specific sectors for service suppliers of the requesting country, these offers will be listed in the offering country’s schedule of commitments, spelling out

exactly what conditions are attached to the opening up of the sector. At the same time the offer becomes automatically binding with respect to all other WTO Members due to the MFN principle.

In respect of public services, i.e. including water and sanitation, the following policy options, are open to all WTO Members under the GATS⁶³

- (i) To maintain the service as a monopoly, public or private;
- (ii) To open the service to competing suppliers, but to restrict access to national companies;
- (iii) To open the service to national and foreign suppliers, but to make no GATS commitments on it;
- (iv) To make GATS commitments covering the right of foreign companies to supply the service, in addition to national suppliers.

A specific commitment will not give an individual (foreign or local) supplier the right to obtain a contract⁶⁴ – in other words there is no legal imperative for privatisation resulting from making specific commitments. Instead, a GATS commitment means that foreign enterprises have the right to bid on calls for offers and to see their offer considered and treated like that of other, national suppliers.

On the other hand, a full market access commitment would mean that governments would be limited in imposing certain requirements on services suppliers (e.g. type of legal entity, duty to form joint ventures with a local company, etc.). It needs to be pointed out though, that there is no duty to make full market access commitments – regulatory measures can be maintained provided they are listed in the schedule of commitments. A cautionary note should be sounded on the approach of some developed countries to propose a “negative list”, i.e. anything not specifically exempted on the schedule for that sector becomes open. Clearly, a negative list approach needs considerable institutional capacity to avoid granting something that was not anticipated⁶⁵.

⁶³ WTO. 2001. *GATS – Fact and Fiction*. Geneva: World Trade Organisation

⁶⁴ Cossy, M. 2005. *Water Services at the WTO*. In “*Freshwater and International Economic Law*” by Jackson, J.H. (Editor). Oxford: Oxford University Press.

⁶⁵ Even more than in current GATS negotiations, the “negative list” approach is promoted in bilateral/ regional Free Trade Agreement negotiations.

10.4.1 Government Procurement⁶⁶

In the context of water services provision, Art. XIII on government procurement is of great relevance. It stipulates that MFN, market access and national treatment shall not apply for government procurement, defined as “services purchased for governmental purposes **and** not with a view to commercial resale or with a view to use in the supply of services for commercial sale”. In other words, whereas the GATS generally applies to the type of services in question, the agreement’s key principles do not apply to government procurement.

Many of the common ways of water provision could escape the disciplines of the GATS

Depending on the interpretation of the definition of government procurement, the Art. XIII exemption could mean that many of the common ways of water provision could escape the disciplines of the GATS. Fully-fledged privatisation of water services is rare, in most cases; governments prefer solutions allowing them to retain the ownership of the facility and contract out certain tasks to a private company. Could

the different types of public-private partnerships (PPPs) such as management contracts, built-operate-transfer (BOT) contracts or concession contracts be considered a form of government procurement? As discussions in relevant WTO bodies (e.g. Working Party on GATS rules) show, Member governments do not share the same views on the matter – partly due to the fact that these instruments often differ in their exact form from country to country and in practice water contracts combine various elements of the different instruments.

The most likely interpretation is that concession contracts cannot be considered a form of government procurement, because there is no purchase of a service from the government; on the contrary, the authorities levy a fee on the concessionaire in exchange for the right granted by the concession. Following that interpretation concession contracts would regularly not fall under Art. XIII and the GATS disciplines would apply in full.

The situation appears to be different for management contracts, whereby, e.g. a private company is entrusted with specific services such as billing or meter reading. In these cases the service would be paid for by government, be destined for infrastructure owned by it and the government would oversee the overall implementation of the contract – all criteria likely to characterise a management contract as government procurement.

⁶⁶ Cossy, M. 2005. Water Services at the WTO. In “Freshwater and International Economic Law” by Jackson, J.H. (Editor). Oxford: Oxford University Press.

However, the interpretation becomes more complex when looking at the second part of the government procurement definition. Whereas the services purchased by the government in the case of management contracts are not being resold, it could be argued that they are made “with a view to use in the supply of services for commercial sale”. In that case, management contracts would not meet all criteria for government procurement and hence not be exempted from GATS disciplines. Ultimately, the interpretation again hinges on the interpretation of the term “commercial” that is also used in Art. I:3 (b).

The interpretation is equally ambivalent as far as BOT contracts are concerned. If one argues that the primary purpose of BOT contracts is the construction of infrastructure, such contracts could be seen as a normal procurement method, meaning that BOT contracts would not be covered by GATS disciplines. If, on the other hand one argues that the primary purpose of a BOT contract is to confer on a private investor the right to provide a service, such contract would not qualify as government procurement and GATS disciplines would apply.

In practice, it appears that a case-by-case determination based on the main elements of a contractual relationship between a public authority and a private contractor needs to be made – meaning that, pending more clear interpretations of the Art. XIII requirements for water services provision (by WTO Dispute Settlement Bodies), governments will be left with some uncertainty as to the exact application of GATS disciplines, which should be considered when entering into any commitments.

10.4.2 GATS and regulation

In general, the GATS recognises the right of Member States to regulate. The preamble of the agreement states:

“recognising the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives and, given asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right;...”

Governments are in principle free to impose any regulatory measures on all service providers, be they domestic or foreign ones. They are also free to impose specific market access conditions and national treatment exemptions on foreign suppliers, **provided these are clearly listed in the country’s Schedule of commitments.**

In South Africa, this is important for example in the context of the country’s Free Basic Water (FBW) policy. If South Africa were to make schedule commitments for water supply under

GATS, the obligation for providers to provide 6kl of water per household free of charge would be a market access condition. The policy can be maintained and made mandatory for foreign private suppliers as long as it is clearly spelled out in the schedule of commitments.

10.5 Concerns about policy and regulatory space under the GATS

Legally, the current GATS text clearly allows countries to maintain regulatory and policy space. Nevertheless, there is widespread concern among civil society groups that changes to the GATS, flowing from the ongoing negotiations, in combination with the capacity constraints facing most developing countries, could effectively undermine the policy and regulatory space of governments, particularly as far as pro-poor measures in developing countries are concerned.

10.5.1 Defining a role for the public sector

There is some concern that the Art. 1:3 (b) exemption for services supplied in the exercise of governmental authority is insufficient for allowing countries a degree of freedom to determine public or private service provision. Tuerk et al.⁶⁷ illustrate with examples that it is legally possible under the GATS to maintain a preference for public service providers in the water sector or to define to what extent and in which areas a mix between public and private service providers is desired. This requires clear definition in a country's schedule of commitments, giving rise to concerns about the capacity in developing countries to deal with the process.

10.5.2 The “lock-in effect”

A frequently voiced concern relating to the GATS is the so-called “lock-in effect”. Whereas it is possible for Members to amend their schedule of commitments, Art. XXI:2 (a) requires that at the request of any Member whose benefits under the agreement may be affected, the “modifying Member shall enter into negotiations with a view to reaching agreement on any necessary compensatory adjustment”. The compensation does not take the form of financial transfers but consists in offering specific commitments in other sectors, which must be granted on a MFN basis. **Note that this issue is not of relevance in connection with the cancellation of individual contracts with private operators.** If a (local) authority wants to cancel a contract with a private company for breach of contractual terms, or should the authority not want to extend a concession after its original contract term, this would not be an issue under the GATS but of contractual law.

⁶⁷ Tuerk, E., Ostrovsky, A. and Speed, R. 2005. GATS and its Impact on Private Sector Participation. In “Freshwater and International Economic Law” by Jackson, J.H. (Editor). Oxford: Oxford University Press.

10.5.3 Article VI requirements

Another major concern of civil society relates to Art. VI of the GATS. While the agreement recognises the right of countries to regulate, it sets out certain conditions for domestic regulation. Art. VI:1 stipulates that Members shall ensure that, “in sectors where specific commitments are undertaken” all measures of general application affecting trade in services are administered in a “reasonable, objective and impartial manner”. Moreover, Art. VI:4 stipulates that regulatory measures should not constitute unnecessary barriers to trade in services and that they should be “not more burdensome than necessary to ensure the quality of the service”. The interpretation of these terms depends on the WTO’s dispute resolution mechanism (see above) and it is feared that unfavourable interpretation could limit the regulatory space of governments⁶⁸.

10.5.4 Maintaining Universal Service Obligations and subsidies

It is feared by civil society, that a government’s ability to maintain universal service obligations (USOs) could be compromised by the GATS. Again, government must make out its commitments in a way that ensures USOs are being met at all times. This includes the possibility of making USOs an integral part of contractual arrangements, including, e.g. the obligation to extend services to previously unserved areas.

10.5.5 Capacity constraints and power imbalances

It has been made clear in the above sections that the GATS gives WTO Member governments considerable latitude for maintaining policy space and establishing a regulatory system that takes cognisance of the country’s specific policy objectives, including pro-poor policies in the water services sector. On the other hand, it is legally very complex to develop commitment schedules in accordance with the GATS while at the same maintaining the desired policy and regulatory space. Many developing countries, including South Africa, have very limited trade law and negotiation capacity in comparison to the complex demands of the international trade system and the GATS in particular. Moreover, the ongoing GATS negotiations require increased capacity in order to keep up with the changes to the system and develop appropriate responses.

A second factor of relevance in the context of maintaining policy and regulatory space are the given power imbalances between different negotiating partners and the inter-linkage between subsidiary agreements. The situation could be aggravated where (water) services

⁶⁸ Kirkpatrick, C. and Parker, D. 2004. *Regulation and the privatisation of water services in developing countries: assessing the impact of the General Agreement on Trade in Services (GATS)*. Manchester: University of Manchester, Institute for Development Policy Management, Centre on Regulation and Competition.

commitments are made while an effectively functioning regulatory system is not yet established. Meeting the obligations of the GATS in terms of regulation requires substantial regulatory capacity. It is therefore essential for any country to have an effective regulatory framework, which can safeguard public interests and contribute to meeting social objectives, before it makes GATS commitments for water services provision.

10.6 South African policy objectives in the light of GATS commitments

On 29 March 2006, South Africa made a conditional initial offer on services under GATS (TN/S/O/ZAF).

The preamble states “this offer cannot be construed as offering in any way the privatisation of public undertakings or as preventing South Africa from regulating public and private services in order to meet national policy objectives”. Furthermore, the offer explicitly excludes the collection, purification and distribution of water for human use. However, water is

implicit in South Africa’s offer to open up “sewage services” as well as “sanitation and similar services“ for consultancy services. Not (yet) having made offers in mode 3 for water and sanitation services leaves South Africa with the possibility of translating its policy objectives into regulatory measures should it make any commitments.

In a recent WRC funded study, Turton et al.⁶⁹ have undertaken an assessment of possible responses for South Africa that would ensure desired policy objectives being met when making commitments under GATS. Tariff setting and water services provider contract regulations are of relevance in the context of water services regulation.

10.7 Conclusion on GATS

The linkages between GATS and water services provision are multi-fold and cover a wide range of areas, including the important aspect of how to maintain the domestic policy and regulatory space for ensuring that

South Africa’s pro-poor policy objectives with respect to water services provision are met.

South Africa has made a conditional initial offer on services under GATS, which would include water services

South African policy makers and regulatory authorities must be aware of the GATS challenges. This is irrespective of the regulatory model.

⁶⁹ Turton, A.R., Earle, A., Malzbender, D., Wilson, J. and Wilcox, O. In press. *Implications of South Africa’s trade policies for water policy and water resources management*. Water Research Commission Report No 1564/1/07. Pretoria

Legally, the GATS text leaves government considerable space to make commitments that take cognisance of domestic policy objectives and allow regulatory measures to be maintained. At the same time, this legal option is complex to exercise in practice and requires substantial trade negotiation and regulatory capacity, which South Africa may not have. The issue of water and sanitation services under the GATS is becoming increasingly relevant and there are international drives to bring water services provision more extensively under the GATS umbrella. South African policy makers and regulatory authorities must be aware of the challenges, particularly the dynamic nature of WTO negotiations, and establish sufficient regulatory capacity before making GATS commitments for water or any other services. A clear picture of the potential linkages between sectors is essential⁷⁰.

⁷⁰ The same level of caution should be exercised in bilateral/ regional Free Trade Agreement negotiations, where the same (or very similar) challenges are faced.

CHAPTER 11

11 WORKSHOP AND SURVEY OF STAKEHOLDERS

11.1 Introduction

A workshop and a survey of stakeholders (the methodology is described in Paragraph 2 above), was conducted as part of the research. The aim was to obtain opinions on regulation and the way forward for water services regulation in South Africa. The detailed outcomes are presented in Annexure 4.

11.2 Outcomes

- There are considerably differing views and understanding of the overall concept of regulation;
- There is no clear preference for a particular model; indeed respondents were expecting greater clarity on responsibilities, roles, functions and the level of independence of any regulator;
- Most of the respondents are of the opinion that water quality is the most important function that needs to be regulated;
- Water services quality was the second most important function that should be regulated
- Most hold the view that all water services institutions including water services authorities, water boards and water service providers should be regulated and some go as far as to include provincial government and other national departments;
- A majority is of the opinion that regulation should be pro-poor but that the concept needs to be carefully applied so as not to engender unintended consequences such as unsustainable institutions;
- Human capacity to implement any form of regulator is a major issue;
- Stakeholders are ambivalent over whether the current enabling, supportive and enforcer roles of DWAF are contradictory.
- Some respondents favour distributing the regulatory tasks between different institutions based on a premise that the institutions will be more focussed and accountable for their specific function. Counter opinion holds that an integrated approach to sector regulation is essential;

- Respondents are divided on whether the regulator should be part of a government department or be independent.
- Those favouring a government department advance the points that:
 - ▣ Government has the role of protecting the poor
 - ▣ DWAF is well placed to house the regulator and has a “head start”;
 - ▣ There was no support for dplg, as the department responsible for local government being the water services regulator;
 - ▣ Some suggest that the regulatory functions should be split between DWAF, dplg and DEAT;
 - ▣ This is the model least demanding on skill and resources.
- Those favouring an independent regulator advance the points that:
 - ▣ There is a lack of trust that DWAF will be able to separate the roles of enforcer, enabler and supporter;
 - ▣ DWAF has not been effective in its existing regulatory role;
 - ▣ An independent regulator is likely to be more effective and can include stakeholders in the governance system; and
 - ▣ An independent regulator will be able to avoid political pressure and influence.

Respondents are divided on whether the regulator should be part of a government department or be independent.

CHAPTER 12

12 CAPACITY REQUIREMENTS FOR REGULATION

12.1 Introduction

The research objective was to undertake a desktop assessment of the capacity and competency requirements as well as the cost implications of regulatory models. Further details of the regulators selected as case studies are in Appendix 1.

12.2 Institutional and Human Capacity for Regulation

Earlier WRC research into **economic** regulation indicates a number of dimensions of institutional capacity that must be in place for any system to be effective. For every system at any level of aggregation, the dimensions of capacity consist of:

- enabling policies which provide purpose and direction;
- laws and regulations that will govern the system;
- a system for ensuring effective management and accountability;
- the available human, financial, information related and other necessary resources; and
- well-structured processes that govern and direct the interrelationships, interdependencies and interactions of all entities involved in the 'delivery chain'.

Components of capacity are:

Policy
Law and Regulations;
Governance
Human and other resources
Processes

According to the African Forum for Utility Regulation (AFUR) 71, a competent, balanced regulatory agency needs skilled management, preferably with a clear separation of the governance structure (policy focused) and management (execution oriented). The key requirements for utilities to function well are well-defined regulatory objectives, roles and responsibilities. A government's policy choices determine the roles and responsibilities of the regulator, which are then defined in legislation and regulations. Because every regulator is defined differently, a direct comparison of capacity requirements has proven to be problematical. This is compounded by a scarcity of data on the case studies.

⁷¹ AFUR (2002) Regulatory Governance: Background paper for the Fourth Meeting: Pretoria, South Africa, 5-7 November 2002

The draft National Water Services Regulation Strategy provides some guidance as it proposes regulation in all of the generally recognised main sub-divisions of water regulation, being social, drinking water quality, environmental health and economic regulation. (It adds water resources regulation but this debateable inclusion is outside the ambit of this research.)

As indicated in section 3 above, the regulator, whether departmental or independent can expect to have to undertake a range of tasks for which capacity is required including

- Investigations into licence applications;
- Monitoring and ensuring compliance with licence conditions, legislation, contracts, etc.;
- Undertaking general research (social, economic, financial, etc.)
- Auditing financial statements of regulated entities;
- Investigating collusion or restrictive practices;
- Dispute resolution;
- Regulatory impact assessment studies;
- Interaction with consumers and stakeholders; and
- Forming legal opinion.

Desirable characteristics of a Regulator are

Clarity of role and objectives
Autonomy
Participatory
Accountability
Transparency
Predictability

In order to perform its regulatory functions the agency should have a range of skills and capacities for working effectively on a number of technical and managerial levels. Domah et al. (2002) cited in Downes and Husbands⁷² (2003) refer to the role of human resources development in achieving regulatory effectiveness. They make the point that "*regulatory institutions should be characterised by **clarity** of roles and objectives, **autonomy** from political intervention, wide **participation** by relevant stakeholders, **accountability** to outside agencies, **transparency** of*

*the decision making process and **predictability** of decisions".* In practice, the attainment of these six criteria hinges on the availability and use of an adequate supply of trained staff involved in regulation. It is not just the total number of staff but a sufficient pool of

⁷² Downes, A. & Husbands, A. Human Resources Systems for Regulatory Institutions: An Imperative for the Caribbean; Paper presented to the 1st Annual Conference of Utility Regulations in the Caribbean 16 -19 September 2003, Trinidad & Tobago

professionally qualified ones (lawyers, technicians, economists and accountants, among others) that will provide the critical institutional continuity of regulation.

12.3 Review of Skills, Capacities and Costs from the Case Studies

12.3.1 Gambia – Public Utilities Regulatory Authority (PURA)

PURA regulates the telecommunications, electricity, water and transportation sectors. The sources of funding for PURA are funds appropriated to it by the National Assembly, grants and license fees and charges.

The institutional capacity of the regulators in the case studies varies greatly depending on circumstance, objectives, mandate, etc.

Besides the Director General and commissioners for water, electricity and telecommunications the agency has key staff in the disciplines of engineering, accountancy, financing, law and economics.

12.3.2 Zambia – National Water Supply and Sanitation Council (NWASCO)

NWASCO regulates 38 licence holders overwhelmingly in the urban water sector.

NWASCO has an internal structure of 15 staff: eight professionals and seven support staff. The staff mix consists of a public relations officer, accountant, human resources officer, finance and management, technical inspectors and financial advisors. NWASCO has implemented a system of volunteer Water Watch Groups (WWG) that initially deals with customer complaints, thus relieving NWASCO of some of the administrative burden.

NAWASCO extends its capacity through volunteer “Water Watch Groups”

NWASCO’s annual expenditure in 2006 was K3.2billion (equivalent to USD705 000). This represents USD 0.21 /person served or US cents0.21 /m3 of water delivered.

12.3.3 Ghana – Public Utilities Regulatory Commission (PURC)

The PURC is an independent body set up to regulate and oversee the provision of electricity and water services.

The commission is supported by a secretariat headed by the executive secretary. The secretariat has staff comprising an executive secretary, technical managers for energy and water, public relations manager, finance manager, assistant manager for customer service, internal auditor, energy analyst, water analyst, and legal officer as well as 6 support staff.

PURC and EWURA are examples of multi-sectoral regulators in developing countries

The Commission's budget proposals are submitted to government for approval and are in most cases subject to budget cuts as happens to other government departments.

12.3.4 Mozambique – Conselho de Regulação de Abastecimento de Água (CRA)

CRA is an entity under public law with a legal personality, and administrative and financial autonomy. Its main mission is to ensure a balance between the quality of the service, the interests of consumers and the financial sustainability of the water supply systems.

CRA has a flexible and limited organisational structure, which includes a professional and multidisciplinary team, with 33 members (core professionals, delegates, academics, contract workers and interns).

CRA's revenue consists mainly of income from contributions from the Public and from the Regulatory Tax paid by the Operators. There is also some additional incomes come from rendered services and other activities. CRA's budget is submitted once every year to the Administrative Tribunal for approval.

12.3.5 Tanzania-Energy and Water Utilities Regulatory Authority (EWURA)

The Energy and Water Utilities Regulatory Authority (EWURA) is an autonomous multi-sectoral regulatory authority responsible for regulation of the electricity, petroleum, natural gas and water sectors. Its functions include, among others, licensing, tariff review, performance monitoring and enforcement of standards of regulated goods and services, taking into account service quality, safety, health and the environment.

The day-to-day activities of the Authority are managed by the Director General, through seven (7) divisions comprising technical directors of electricity, petroleum, natural gas, water and sewerage, regulatory economics, legal services and corporate affairs, internal audit, public relations and procurement. In the period of 2006/2007 the authority had recruited 42 staff. When fully fledged, EWURA will have about 75 highly qualified professionals coming from both the public and private sectors, thus bringing wide variety of experiences.

Sources of funding for EWURA are revenue collected from its activities and donor and government funding.

12.3.6 England and Wales – Water Services Regulation Authority (Ofwat)

Ofwat is the **economic** regulator of the water and sewerage industry in England and Wales. Consumer interests are represented by a separate independent organisation, the Consumer Council for Water (CCWater) that monitors water services.

The structure of the regulatory agency comprises six divisions being Finance and Competition, Network Regulation, Consumer Protection, Corporate Affairs, Operations and Legal services. It has a staff of 193.

Ofwat is financially independent and its income is from licence fees. It has an annual expenditure of GBP13 million, which is equivalent to 60p per customer of the regulated entities.

12.3.7 Brazil – Municipal Department of Water and Sanitary Sewage (DMAE)

DMAE is an autonomous municipal organisation with legal personality and financial self-sufficiency.

The *Conselho Deliberativo* (Deliberative Council) controls and approves all operations and decisions taken by DMAE management. The model is thus one of self-regulation modified by the addition of the *Conselho Deliberativo*. Self-regulation costs are paid from operational income.

12.3.8 Philippines – Metro Manila Water and Sewerage System (MWSS)

The Metro Manila Water and Sewerage System (MWSS) has a Regulatory Office (RO) established to monitor and enforce compliance by concessionaires of their contractual obligations under the concession agreement, implement rate adjustments, arrange for public

dissemination of relevant information, respond to complaints against concessionaires, and prosecute or defend proceedings before the Appeals panel.

There are about 60 employees in the RO, headed by a Chief Regulator and four regulators for technical, financial, and customer service regulations as well as for administration and legal matters.

Concessionaires paid a commencement fee of USD5 million, which was used to pay the cost of privatisation. Operations of the RO are paid for from ongoing concession fees.

12.3.9 National Energy Regulator of South Africa (NERSA)

The National Energy Regulator of South Africa regulates three separate sub-sectors namely electricity, petroleum pipelines and piped gas.

NERSA employs 109 staff for all three sub-sectors.

NERSA derives all its income from levies, its investments and other internal sources. The regulator's operating expenditure in 2006/07 was:

- Electricity R33 million;
- Pipelines R25 million; and
- Piped Gas R27 million.

12.4 Lessons from review of regulatory capacity requirements

12.4.1 A Review of Skills and Competencies from the case studies

From the review of the cases, it is clear that each country has its unique political, economic, cultural, legal and institutional environment and consequently organisational structuring also differs. Nevertheless, apart from general management, certain skills were found to be common in most of the cases reviewed.

- **Engineering skills** appear to be essential for a sound understanding of the sector and for the setting and evaluation of sector performance indicators and the evaluation of assets and operational efficiency;
- **Financial skills** are important for the analysis of the financial performance of the sector and of the operators and providers especially in relation to tariffs and affordability;

- **Economic skills** are necessary for an understanding of the economic circumstances of the economy and of the sector including through the construction of macro- and micro-economic models;
- **Legal skills** are essential in all matters related to interpreting the regulator's mandate, enforcement and compliance as well as the legal consequences of any determination by the regulator;
- **Social skills** are necessary for the regulators outreach programme and resolving consumer complaints;
- **Communication skills** are essential if the regulator is to publicise its activities and make consumers aware of their rights.

The organisational structure of the regulators in the case studies varies considerably but generally follows a functional structure that aligns with the above skills.

12.4.2 A Review of Regulatory Costs

One of the key issues for consideration in institutional and organisational arrangements for regulation is finance and budget. This encompasses the sources of funding and their sustainability as well as the cost implications of putting up and operating a fully-fledged regulatory agency. The review of the cases with regard to the funding sources and costs related to regulation gives a whole range of funding options depending on the regulatory model, functions and objectives.

Most independent regulators derive most of their income from licence and other fees that are charged to the regulated entities. Less common are government budgets and donor funding. As extremes, NERSA (South Africa) receives a considerable surplus from a formula-based licence fee structure while PURC (Gambia) regularly has to curtail operations due to the vagaries of government budgets.

Independent regulators derive most of their income from licence and other fees that are charged to the regulated entities

Most of regulator expenditure is devoted to salaries of staff. Other noteworthy items are research, communication and technical assistance. Several regulators rely on consultants for specialised work such as auditing the accounts and submissions of regulated entities.

Most of regulator expenditure is salaries of staff

There are too many variables in the setup of regulators and too little financial information in the case studies to be able to **quantify** the cost of an independent regulator with any confidence. Nevertheless, based on the annual NERSA cost of R33 million for regulating the electricity industry, the NWASCO cost of USD0.21 per capita and the Ofwat cost of GBP0.6 per customer, the range of annual cost, for an independent South African water services regulator dealing with the full range of regulatory functions, can be estimated as R60-R99 million per annum (see Deliverable 5). Similarly, for a departmental regulator a conceptual organisational structure was developed and using reported personnel expenditure in DWAF the expenditure range was estimated as R40-R67 million.

12.5 Emerging Issues from the Review

Regulation as an activity is highly knowledge and information intensive, thereby requiring highly skilled, competent human resource capital and financial resources. An important aspect of the operations of the regulatory agencies is ability to discharge adequately and effectively the tasks for which they were established. The quantity and quality of the human resource base of these new regulatory institutions are critical to their success.

The quantity and quality of the human resource base of regulatory institutions are critical to their success

Various studies have been conducted in the country to assess whether or not there is sufficient capacity to ensure adequate implementation of different aspects of water management including water services. A WRC report⁷³ on Capacity Needs for Water Services Sector highlights states that there is a general shortage of skills in the country in the areas of engineering professionals, technical, financial and strategic management in the

⁷³ WRC (2007a) Review Of The Current State Of Capacity Building And Skills Development For Water Resources Management Within South Africa Phase 2 – Report 1 WRC (2007b) Assessment of Training Programmes and Capacity Needs for the Water Sector

water services sector. According to this report, the shortage of skills in the water sector is attributed to:

- The country's rapid economic growth increasing demand for skilled personnel
- General transformation of human resources in the past ten years
- Skills drain due to emigration

In a nutshell, the regulatory skills are required in circumstances where general capacity and skills availability is a challenge.

CHAPTER 13

13 ADAPTING INTERNATIONAL BEST PRACTICE TO SOUTH AFRICA

The purpose of this chapter is to find resonance between South African circumstances and international regulatory best practice.

13.1 Overview of Regulatory Determinants in South Africa

The analysis of the South African socio-economic setting, legislation, institutions and policy has revealed the characteristics that will influence the institutional form and mandate of a regulator. A brief overview of the outcomes of the analysis made in earlier chapters related to “pro-poor” and regulation is provided hereunder for convenience.

The **Constitution** provides that everyone has a right of access to sufficient water and places on government the responsibility to realise this right progressively. Moreover local government is required to give priority to the basic needs of the community. The Constitution also provides for the division of functions between the national, provincial and local spheres of government. Local government has the executive authority and the right to administer water and sanitation services within its jurisdiction but must do so within the bounds of national and provincial legislation. National and provincial government must support and strengthen the capacity of local government.

Legislation in the local government and water sectors give effect to the Constitutional provisions and include objectives of equity and poverty alleviation. There are general provisions for delegation of ministerial powers of supervision but no direct reference to the institution of an independent regulator. However, legislation in the energy and telecommunication sectors demonstrates that special legislation can be used to set up an independent regulator.

By way of the Constitutional assignment of functions and the provisions of the Local Government: Municipal Structures Act and the Water Services Act, the municipality *ipso jure* becomes the water services authority. It then has the prerogative to itself be the water services provider or to appoint another institution to fulfil this role. With government as the regulator this does not present any particular difficulty but with an independent regulator, new

legislation would have to clarify which of the authority or the provider or both was subject to regulation.

All of the macro-economic and sectoral **policy and strategy** instruments issued by government since 1994 set as priorities the alleviation of poverty and the extension of services to the un-served. Government policy would thus unequivocally support a “pro-poor” regulatory paradigm.

The policy stance on **independent regulation** is ambivalent. The policy on municipal service partnerships is to afford equal opportunity to public-private sector partnerships, which almost necessarily implies independent regulation. The water sector policy states that DWAF will be the national regulator and that other existing government institutions will have subsidiary regulatory roles. The policy envisages that independent regulation will only be assessed in the future. This is different to the approach in the electricity sector where an NERSA, an independent regulator has been established.

The **institutional** analysis reveals that there is great variation in the capacity of sector institutions to regulate or to accommodate the demands of being formally regulated. This is particularly in relation to engineering skills at local government level⁷⁴.

13.2 Independent or Departmental Regulation

The reasons advanced for having independent regulation are:

- Increased transparency and predictability;
- Greater attention to the power balance between service provider and consumer;
- More vigorous attention to correcting deficiencies;
- Greater attention to long-term sustainability;
- Lower susceptibility to corruption; and
- Isolation from short-term political imperatives.

The arguments for avoiding independent regulation are:

- Increased costs to consumers and to service providers⁷⁵;
- Further legislation is required;
- Lack of capacity in service providers to meet regulatory reporting requirements.

⁷⁴ Allyson Lawless. Numbers and Needs: Addressing imbalances in the civil engineering profession. SAICE. October 2005.

⁷⁵ This refers to increased direct costs – where a regulator functions effectively these will be (more than) made up for through increased efficiency in the sector as well as increased service delivery standards.

The reasons advanced for conventional government regulation by line departments are:

- Direct link between regulation outcomes and structuring support programmes;
- Direct response to policy shifts;
- Simplicity in the authority relationships; and
- Greater empathy with the problems of the poor.

The arguments for avoiding conventional government regulation are:

- Conflict of interest in the regulatory versus support roles;
- Interest in suppressing publication of bad news;
- Lack of priority in national departments for regulatory tasks;
- Lack of capacity and inability to recruit appropriate skills; and
- General inability of large bureaucracies to be sufficiently responsive.

International practice suggests that regulation by line departments will be decidedly “pro-poor” but subject to short-term political exigencies and weak on long-term sustainability. This preparatory paper will therefore focus on the alternative of a national independent regulator that is favoured by the majority of international commentators. Note that at local government level the water services authority is often its own water services provider, in which case it currently practices self-regulation. When it appoints a separate public or private water services provider it is required to “regulate” the water services provider by entering into a service delivery agreement (section 76(b) and 81(1)(a) of the Municipal Systems Act, 2000)

13.3 Setting up a National Independent Water Regulator In SA

13.3.1 Legislation

The analysis in this research finds that the preferable option is to pass new legislation to establish the independent regulator and to provide for its functions and powers. This follows the example already set by the energy sector. It will be necessary to undertake an intensive legal review of the Water Services Act to eliminate conflicts with the powers of the Minister and to avoid situations where a water services authority or provider has to answer to two authorities on any point. The legislative introduction of a licensing system and the clarification of whether the water services authority or the water services provider or both are to be regulated are other matters that require more intensive legal scrutiny.

The objectives, functions and powers are determined and prioritised according to government’s long term policy objectives and must be written into the founding act rather than added by later ministerial regulations. In order to achieve a “pro-poor” regulatory

dispensation the characteristics listed in the paragraph above must be emphasised. Examples could be an emphasis on extending services to the poor, education and empowerment of consumers, special dispute resolution mechanisms, etc.

13.3.2 Governance

The Board should be set up by procedures similar to those already in the Water Services Act for the appointment of water boards and to those in the energy sector. This involves prescribed institutions nominating candidates for appointment by the Minister. The selection and balance of institutions can provide a “pro-poor” pre-disposition in the Board. Candidates could be nominated by civil society such as professional associations, trade unions, NGOs, the Association of Water Utilities, SALGA and government departments. Appointments, once made, are not subject to termination unless there are exceptional circumstances such as proven corruption. The Board must appoint the chief executive, not the Minister.

The Regulator should report to Parliament without intercession by the line departments. The manual it prepares in terms of the Promotion of Access to Information Act needs special attention to ensure that the qualities of openness and transparency are sustained.

13.3.3 Conceptual Organisation

In Deliverable 5 (attached) a conceptual organisational model was developed through the process of function, skills requirements, organisational structure and costs. Three scenarios were developed for firstly, a threshold level to make the endeavour meaningful, secondly, a focus on pro-poor regulation and thirdly, a comprehensive example. The outcome of this desktop analysis is presented in the table below:

CONCEPTUAL INDEPENDENT REGULATOR			
	MODEL 1 BASIC	MODEL 2 PRO-POOR	MODEL 3 COMPREHENSIVE
NUMBER OF STAFF	65	88	112
TOTAL ANNUAL EXPENDITURE	R63 000 000	R75 000 000	R99 000 000

A regulator requires considerable institutional capacity and this may take some time to accumulate. Contracting in capacity is a short and long term alternative⁷⁶.

13.3.4 Finance

The system whereby the Water Research Commission is financed principally from a levy on every cubic metre of water abstracted provides a predictable income stream that is not subject to the vagaries of the national budgeting process. This sound approach should be emulated for the independent water regulator.

13.4 Setting up a Departmental Water Regulator In SA

The institutional and legislative review of this study has shown that existing legislation already allows for a water services regulatory function within DWAF. The DWAF initiative to develop a draft national regulatory strategy has examined this matter in considerable detail and this research will not repeat that work.

For comparison with the above analysis of an independent regulator, a similar design for a departmental regulator was prepared in Deliverable 5 and the outcome is presented in the table below:

COST OF A DEPARTMENTAL REGULATOR			
	MODEL 1 BASIC	MODEL 2 PRO-POOR	MODEL 3 COMPREHENSIVE
NUMBER OF DIRECT STAFF	48	65	81
TOTAL ANNUAL EXPENDITURE ON DIRECT STAFF (R million)	26	36	45
ALLOW 1/3 OF EXPENDITURE FOR SERVICES FROM OTHER DEPT UNITS (R million)	14	18	22
TOTAL ANNUAL EXPENDITURE	R40 000 000	R54 000 000	R67 000 000

13.5 Dispute Resolution Mechanism

The Chilean case demonstrates the advantages of a dispute resolution mechanism where the decisions of the regulator can be challenged by arbitration. In South Africa, the Water Tribunal provides for an appeal mechanism against administrative decisions made in terms of the National Water Act. A similar tribunal, or even the Water Tribunal itself, could be tasked with hearing appeals against the regulator, whether independent or departmental.

⁷⁶ Sophie Trémolet, Padmesh Shukla and Courtenay Venton. Contracting Out Utility Regulatory Functions. Reference 0002524. Environmental Resources Management for the World Bank. January 2004.

CHAPTER 14

14 CONCLUSIONS

Frequent incidents of non-compliance with potable water quality standards, the discharge of raw sewage into river systems and the deterioration in water supply system assets through operating deficiencies and lack of maintenance, has increasingly brought into focus the question of the regulatory framework for water and sanitation services.

This research was conducted to make proposals on the form a regulator of water services in South Africa might take bearing in mind international experience and the particular circumstances in the country. The research included an international literature review, case studies, a review of South African legal and policy frameworks, analysis of institutions and surveying the opinions of stakeholders. A particular focus was placed on “pro-poor” regulation and a special section devoted to the potential impact of the General Agreement on Trade in Services on regulation.

14.1 Literature Review

The literature review revealed that there is a widely held belief that every water service provider whether public or private, needs some form of regulation. This is to ensure that there is alignment between nationally held goals and objectives and those of the institutions that must deliver the service. Service providers must be held publically accountable for their performance.

In the **widest** sense “regulation”, “regulations”, “by-laws”, “regulatory functions” and “regulator” could apply to all of the functions of all spheres of government. This usage tends to diffuse responsibility and accountability. In this research, the contemporary **narrower** international usage of the concept of a “regulator” and “regulatory functions”, in which the principal characteristic is the separation of the setting of policy, norms and standards from the monitoring and enforcement functions, is preferred. In this narrower sense, the terms are taken to imply a specific institution established for the purpose of confirming and ensuring that the providers of water services are meeting the socio-economic objectives and following the existing norms and standards of the broader society. In the wider sense, regulation involves applying the authority of the state through legislation in all its forms.

The African Forum for Utility Regulators identifies nine “principles” of best practice regulation to be communication, consultation, consistency, predictability, flexibility, independence, accountability, transparency, effectiveness and efficiency. In order to achieve these, there must be a governance system established by legislation and sufficient human and financial resources to ensure skilled and independent management.

14.2 The Case Studies

The review of international literature and regulators found a considerable variety in the models applied but that basically there was really only a policy level choice between a government line department as regulator and an independent regulator. The secondary aspects of the model chosen depended on the particular circumstances and included determinants such as the division of powers in federal states, multi-sectoral regulation, “contract” regulation at local level, specialisation on for example economic regulation, level of public participation, etc.

The institutional form that a regulator takes does not impact materially on the functions that it must perform, the legislation and policy that it must apply or the methods that it uses for gaining compliance. What matters is the mandate that is given to the regulator by legislation, delegation or regulations. This research paid particular attention to whether this was true for so-called “pro-poor” regulation and found it to be the case.

The case studies generally demonstrate the principles proposed by AFUR but the two that are most frequently mentioned are independence and adequate financing factors which are in fact interdependent. Local level regulators appear less successful.

14.3 The South African Circumstances

The research found that the South African legal and institutional framework could accommodate these best practices and indeed many aspects were specifically included in the existing frameworks such as financial accountability through the Municipal Finance Management Act. The South African legal framework also provides clear responsibilities in the sector, the absence of which detracted from the efficacy of the regulators in some of the case studies. There are Constitutional and legislative commitments to participation in governmental processes and this would extend to regulation. International best practice could be incorporated into the detailed design of the mandate of any form of South African regulator.

In South Africa, local authorities bear the Constitutional responsibility to provide water services. Overwhelmingly, the local authorities are also the services providers with only a few small, relatively unsuccessful examples of experiments with private sector providers. Any regulation is thus of one state institution on another. Any dispute between the regulator and a regulated entity must then be resolved in the framework of the Constitutional provisions on co-operative government and the empowering legislation. A dispute mechanism would be highly desirable.

If the purpose of regulation is to ensure that the objectives of the broad society are met then the logical location of the regulator is at the level where most policy and legislation are framed. In South Africa's case, national government establishes most of the frameworks. Coupled with weaknesses in the local sphere of government and reinforced by the generally poor performance of municipal regulators internationally, it is rational to favour a national regulator. Moreover, the experience of local government regulation is that it is usually of the "regulation-by-contract" form where the issues revolve around what is in the contract rather than what is in legislation and policy.

The research found that an independent regulator is a viable option to the departmental regulation proposed in the draft National Water Services Regulation Strategy. Indeed, this is the form most discussed in the international discourse on regulation. The relative merits of each were identified. The principal difference being effectiveness in that departmental regulation would be subject to the vagaries of the government's internal human and financial resource allocation processes and have to continually compete, in the short-term, with other priority functions of government whereas independent regulation is likely to be more focussed and accountable. An independent regulator is likely to be more costly although more cost transparent. It also seems rational that the water sector follows the electricity sector, which has the independent regulator, NERSA.

Regulation should be directed at institutions that are responsible for delivering water services. Water boards are necessarily included. The distinction made in the Water Services Act between authorities and providers creates some uncertainty in this regard. A local municipality becomes the water services authority through the operation of law. A water services provider on the other hand becomes such through a contractual relationship with the authority. Although all institutions must comply with the law, the authority has the statutory obligation to supply services and is therefore the logical target of regulation. The authority meets its obligations by enforcing its contract with the provider. There is also the legal point that any direct regulation of a provider may constitute an infringement of a municipality's

executive authority and right to administer the function in terms of section 156 of the Constitution.

An effective regulator, whether independent of departmental will require considerable skills that are in short supply in South Africa.

14.4 Stakeholder Views

The stakeholder survey, undertaken as part of the research, found stakeholders to be divided on the form of the regulator. Stakeholders are of the view that all water services institutions and even extending to other state institutions with a role in water services should be regulated.

A concern of most non-DWAF individuals surveyed is that the departmental regulator will not be able to simultaneously fulfil its enabler and supporter roles.

14.5 Finding

The poor state of South Africa's water and sanitation services, notwithstanding a sound legislative and policy framework, point to the need for a new regulatory regime. The regulator would need to focus on social, health and environmental issues.

In South Africa, most policy and legislation for the water services sector is formulated by national government and it follows that the scope of a regulator should also be national. Precedent for this exists in the electricity sector.

The key success factors for a regulator are independence and adequate financing. The separation of the policy and legislative functions from their regulation is a logical consequence.

A departmental regulator cannot be truly independent and will always suffer from uncertainty in the budgeting process.

The down-side of an independent regulator is higher regulatory costs and higher demand on the supply of scarce skills.

On the balance of the evidence these researchers conclude that an independent regulator of water and sanitation services financed by a mechanism such as a levy on withdrawals or service accounts should be the preferred choice. The regulator would have a staff of between 65 and 112 and cost between R63 million and R99 million per annum.

On the ancillary issues, the research found that a “pro-poor” approach can be introduced into any regulator as it depends on the mandate given to the regulator rather than the form of the regulator. The General Agreement on Trade in Services is not a threat to regulation but that sector officials need to understand the process and be vigilant.