



Policy Brief

Assessing the Effectiveness of Intergovernmental Fiscal Relations Instruments in Addressing Water Challenges

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EXECUTIVE SUMMARY

The overarching goal of national water management is to achieve water security. Water supplies in South Africa's larger cities are of good quality and safe to drink, but this is not the case in smaller towns and rural areas. Reliable bulk water supply is also failing or at risk, even in the major metropolitan municipalities. While intergovernmental transfers through the equitable share allocation and conditional grants have enabled poorer municipalities to address their water services goals, the progress in enhancing services has slowed. In this context, the Financial and Fiscal Commission assesses how fiscal instruments and other measures in the IGFR framework can assist in achieving the National Development Plan's (NDP) goal of ensuring that all South Africans have affordable, reliable access to sufficient, safe water and hygienic sanitation. The Commission concludes that the current IGFR instruments for water services may no longer be fit for purpose, and that a review of them is needed.

For an equitable sharing of national revenue.

BACKGROUND

The legal framework of providing water services and managing water resources derives from the 1996 Constitution. Section 27 of the Constitution provides for the right to have access to sufficient water and for the state to achieve the progressive realisation of this right. To give effect to this right, the national Department of Water and Sanitation (DWS) manages the water resource while municipalities manage the provision of water services. In addition, the DWS, together with National Treasury (NT) and the Department of Cooperative Governance (DCoG), maintain regulatory oversight of municipal service provision. Water Boards provide regional bulk water services. Municipalities fund the costs of providing water services using their own revenues, loans and transfers from national government. The specific IGFR instruments include:

- The Local Government Equitable Share (LES) allocation, which supports municipalities in, among others, their water services provision.
- Several water-related conditional grants, namely:
 - The Municipal Infrastructure Grant (MIG) whose goal is to subsidise the capital costs of providing basic services to poor households
 - The Regional Bulk Infrastructure Grant (RBIG) whose goal is to facilitate successful execution and implementation of bulk projects of regional significance.
 - The Water Services Infrastructure Grant (WSIG) whose goal is to assist water services authorities to reduce water and sanitation backlogs¹.

National Treasury is the transferring agent for the LES, while DCoG is the transferring department for the MIG and DWS transfers the other grants. In addition, the National Water Act, 1998 (Act No. 36 of 1998) (NWA) also allows the Minister of Water and Sanitation to give financial assistance for specific purposes. This provision is used primarily to support resource-poor farmers as well as for small grants to promote rainwater harvesting for household use.

Despite the comprehensive policy and institutional framework, there is well-founded concern about the state of water services in South Africa. In 2017, 95 per cent of households had access to water supply infrastructure, while 85 per cent to functional infrastructure and only 65 per cent to reliably functioning infrastructure². Even where water supply infrastructure is in place, reliable supply is declining, and the safety of water can no longer be assured in many municipalities. Water supplies in South Africa's larger cities are of good quality and safe to drink but this is not the case in smaller towns and rural areas. Services often do not meet the basic minimum standards prescribed in regulations. The standard for reliability is that "no consumer is without a supply for more than seven full days in any year". Many communities go without public water supply for weeks and months at a time, particularly in hot weather when consumption rises. The challenge is particularly acute in rural areas.

Sanitation provision is often unsatisfactory, even where it nominally meets basic minimum standards, and wastewater treatment failures result in serious water pollution. The lack of hygienic safety of shared household sanitation facilities in dense urban informal settlements is

¹ "The water services infrastructure grant has been created through the merger of the municipal water infrastructure grant, the water services operating subsidy grant, and the rural household infrastructure grant. This grant aims to accelerate the delivery of clean water and sanitation facilities to communities that do not have access to basic water services." (GoSA – DoRA 2016)

² DWS 2017

a problem that must be addressed through urban development rather than sanitation specific investments. Many of these problems are due to poor municipal management. However, reliable bulk water supply, the terrain of Water Boards, is also failing or at risk, even in major metropolitan municipalities. Water supply failures also cause water-borne sanitation systems to fail. In addition, high levels of “non-revenue water³” reduce incentives for its efficient use.

The Constitution and legislation require that local government services provision should be financially sustainable, considering user payments, grants and other revenue. This goal has seldom been achieved and there is growing concern about the financial viability of water services. Assessing this is difficult since few municipalities comply with the WSA requirement to maintain ring-fenced financial accounts for their water services.

RESEARCH FINDINGS

The Commission’s assessment indicates that the existing IGFR tools, namely the equitable share allocation and conditional grants, have enabled poorer municipalities to address their water service goals to develop and operate the infrastructure required to provide basic minimum water services. In fact, these fiscal transfers have underpinned the progress made in expanding services to date. However, this progress in expanding services, is now slowing. The DWS and the SALGA acknowledge that the number in households with safe and reliable water supplies is declining. In addition, National Treasury reports that the progress in reducing physical service backlogs is slowing even as allocations for infrastructure increase. Overall, in terms of water security and the Sustainable Development Goals (SDGs) of safe and reliable water services, current spending is associated with decline, and not progress (Table 1).

Table 1. Number and percentage change of households (hh) with access to services

	2001-2011 No. hh	2001-2011 % hh	2011-2016 No. hh	2011-2016 % hh
Electricity	4 427 127	57%	3 085 170	25%
Water	4 218 878	52%	1 769 242	14%
Refuse	4 248 215	68%	1 526 018	15%
Sanitation	3 187 490	45%	3 236 805	31%

Source: Parliamentary Monitoring Group, 2017a

This suggests in turn that the current IGFR instruments for water services may no longer be fit for purpose.

Table 2 shows the quanta and trends in respect of water-related conditional grants budgets between 2015/16 and 2020/21. The trends indicate:

- nominal year-on-year increases but real declines
- a trend of a greater proportion of funds allocated directly to municipalities rather than to projects implemented by the national DWS, and
- that the LES allocation calculated for operations and maintenance (O&M) is roughly 8 per cent of ‘estimated basic needs’ related capital investment.

³ Non-revenue water is water that has been produced and is "lost" before it reaches the customer. Losses can be real losses (through leaks, sometimes also referred to as physical losses) or apparent losses (for example through theft or metering inaccuracies).

However, without detailed studies of specific municipalities, the extent to which funds allocated for both investment and O&M are applied to the intended purpose, cannot be evaluated.

Table 2. Principal water related grants, 2015/16-2020/21

	R'000 2015/16	R'000 2016/17	R'000 2017/18	R'000 2018/19	R'000 2019/20	R'000 2020/21
MIG	14 955 762	14 914 028	15 981 252	15 287 685	15 733 731	16 599 086
<i>water comp</i>	4 486 729	4 474 208	4 794 376	4 586 306	4 720 119	4 979 726
RBIG *	0	1 850 000	1 865 000	1 957 000	2 066 360	2 180 005
<i>forward estimates</i>		5 323 602	4 854 782			
RBIG-ptB **	4 858 000	3 478 829	2 773 559	2 880 922	3 037 295	3 204 346
<i>forward estimates</i>		3 479 000	2 806 279			
WSIG-ptA ***	1 853 114	2 844 982	3 329 464	3 481 056	3 669 319	3 870 972
<i>forward estimates</i>		1 511 545	3 729 864			
WSIG-ptB ***	1 834 456	311 545	587 122	608 175	642 233	677 556
<i>forward estimates</i>			587 122			
Total water-related	13 032 299	12 959 564	13 349 521	13 513 459	14 135 326	14 912 605
Annual change %		-1%	3%	1%	5%	5%
LG Equitable Share				62 731 845	68 973 465	75 683 326
<i>Water items</i>				26 030 000	28 619 903	31 404 098
<i>% of LGES</i>				41%	41%	41%
<i>LGES as % of annual capital grants</i>				193%	202%	211%
<i>LGES as % of 'basic needs' capital installed ****</i>				7%	8%	8%
Direct grants	6 339 843	9 169 190	9 988 840	10 024 362	10 455 798	11 030 703
<i>Percentage of total</i>	49%	71%	75%	74%	74%	74%
In-kind	6 692 456	3 790 374	3 360 681	3 489 097	3 679 528	3 881 902
<i>Percentage of total</i>	51%	29%	25%	26%	26%	26%

Source: FFC calculations based on National Treasury Division of Revenue Act data

Note: * Specific purpose allocations to municipalities

** Allocations in kind

*** Incorporated Rural Household Infrastructure Grant (RHIG) and operational subsidy in 2016

**** Muni capital installed for basic and R7 billion each per 50 districts

A critical challenge in the sector is inadequate expenditure on O&M which is leading to service failures. This is partly because the current IGFR system incentivises the over-provision of physical infrastructure without equally providing for related O&M costs. The conditional grant system was developed to prioritise and expand the coverage of water services, up to at least a basic minimum standard. The focus was thus on providing grants to municipalities for the necessary capital projects, notably in communities where there were no formal services.

However, after expanding coverage, the focus has now moved to functionality and the sustainability of the services, with some municipalities seeking to increase service standards.

The failure to properly operate and maintain the infrastructure on which water services depend is a matter for serious concern. Furthermore, the infrastructure expenditure incurred on expansion beyond basic needs is not cost effective because it is addressing secondary goals instead of constitutionally mandated priorities (i.e. safety and reliability). Consequently, incentives to over-invest in infrastructure come at the expense of O&M and water quality.

In the current climate of fiscal constraint, it is therefore appropriate to review the goals, structure and performance of the system of IGFR transfers for water services. Furthermore, a review of the IGFR system to improve the performance of the water services sector must be linked to a broader strategy to address the ongoing challenge to improve governance at both national and municipal levels. In terms of the Constitution, the primary responsibility for municipal oversight resides with the provinces. Given the poor outcomes, the roles and performance of the municipal sphere in the water sector should be reviewed.

The performance of the IGFR in respect of water provision must be addressed at several levels, namely technical, institutional, financial, strategic and compliance. Overall, the Commission's analysis suggests a wide range of policy and operational issues that need to be addressed if the overall goal of water security and access to at least a basic minimum service is to be achieved.

CONCLUSION

The current climate of fiscal constraint warrants government's strategic intervention to achieve water services policy goals as well as the broader commitment to achieving the SDGs. Properly operating and maintaining water services infrastructure are crucial. To this end, national government must prioritise its investment and operational funding support to municipalities to ensure maximum impact and the sustainability of water services. In addition, conditional grant funding should have, as targets, budgetary and physically sustainable projects. This will require greater attention to, and oversight of, the governance, financial management, staffing and operational arrangements at the municipal level.

RECOMMENDATIONS

The Commission recommends that:

- 1) *a review of basic norms and standards for water services be undertaken by the Department of Water and Sanitation (DWS);*
- 2) *stronger conditions be attached to financial transfers to ensure compliance and that funds allocated are properly spent for the purposes indicated;*
- 3) *the IGFR system shift to incentivising sustainable operations and maintenance and introduce a dimension of outcome-based support for higher levels of service.*

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