

# Private sector participation in municipal water supply and sanitation services

by Barry M Jackson (barry@dbsa.org)  
Principal Policy Analyst  
Policy Business Unit  
Development Bank of Southern Africa  
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## SYNOPSIS ▲

This note looks at the forces which are influencing thinking on private sector participation (PSP) in water supply and sanitation services. These include demographics and incomes, service levels and associated backlogs in South Africa, and the projected demand for new investment. It refers to current policy developments which will influence future investment decisions and looks at the perspectives held by different stakeholders. In summary, South Africa is moving towards the point where the merits and constraints of PSP are sufficiently well understood to allow a well-reasoned choice of the approach to be followed.

## BACKGROUND ▲

Some background would be useful in understanding the recent policy shifts in South Africa. The new government is committed to redressing the significant inequities of the past. Estimates vary, but if we assume South Africa's population as 43,8 million in 1995, about 52% are urban, and 18% urban dwellers (4 million) have only a minimal water supply, or none at all. The equivalent figure for lack of urban sanitation is 22%. In rural areas, it is estimated that 40 - 60% of the population (8 - 12 million) does not have an adequate water supply service (in South Africa, this is defined as a reliable 25 litres/capita/day within 200 metres walking distance).

The areas in which most of these people live were systematically neglected by the previous government, either in terms of inadequate investment, or poor operations and maintenance, or both. In the towns, the residents used their only political weapon: non-payment for services, a trend which the present government is finding difficult to reverse, particularly since there are few signs of the services improving. There is a dual economy, with well run "white" towns next door to barely functioning "black townships". This situation has recently changed with the unification of previously separated urban areas, and democratically elected (legitimate) local councils, but it will take a long time, and many resources, to bring services to comparable levels.

It is estimated that between 50 and 80 billion South African Rand are needed over the next ten years to eliminate the backlogs in services in the urban areas, depending on the level of service provided. Some of this will come in the form of government grants for a basic level of service, but the majority will need to be borrowed. To borrow funds on the open market, a service supplier will need to demonstrate its capacity to repay, which is not easy under present circumstances. In rural areas, it is estimated that R10 - 15 billion are needed to bring water supplies up to a basic level of service, and over R2 billion to assist in the provision of sanitation, over the next ten years. Most of this would be in the form of grants.

### **MOVING TOWARDS INCREASING PRIVATE SECTOR PARTICIPATIONS (PSP)**

Most South African public authorities employ the private sector to design and construct public infrastructure, such as water supply and sanitation systems. South Africa has a strong consulting engineering fraternity and a large contracting industry.

Public infrastructure has been funded in a variety of ways. The water boards and the larger municipalities have usually raised funds from the private sector capital market. The smaller, formerly "white", local authorities tended to use operating surpluses to fund capital expenditure, with some access to a government-sponsored loan fund and partial grants for reducing "environmental" problems. Formerly "black" local authorities were dependent on government grants and concessional finance from the Development Bank of Southern Africa (DBSA).

The combining of "black" and "white" local authorities means that operating surpluses no longer exist and that capital expenditure must be externally financed. This will be through a mix of government grants (sufficient to achieve a basic level of service), concessionary finance from the DBSA, and loans from the local capital market. As a development finance institution, the DBSA will aim to assist borrowers to enter the capital market for their future finance. Over the next few years there will be much emphasis on co-financing (DBSA and private capital), until the private sector capital market is fully able, and willing, to finance all infrastructure provision. The realisation of this aim might require local authorities to review their current ways of operating, and to explore alternative arrangements for providing public services. In general, where there was sufficient economic activity to pay for a reliable service, there was ample evidence of efficient and professionally run systems. However, in many parts of the country, there has been consistent under-funding, leading to services which are inadequate both in quantity and quality.

The Water Research Commission released guidelines to assist public sector service suppliers to understand and manage the use of private sector participation in water supply and sanitation services. The guidelines draw from both South African and international experience. They acknowledge that water and sanitation services in South Africa are largely seen as public goods which have been traditionally rendered by the public sector, but this has not in itself produced either a better or a worse service. As in most service industries, the quality and value-for-money received are directly related to the clarity with which the product or service is specified and the way in which quality control is applied.

### **CURRENT THINKING ON PSP ▲**

Central government has made clear its commitment to exploring PSP further. The government's recently published Growth, Employment And Redistribution (GEAR) strategy states: "Recognising the limited capacity of the fiscus, government is committed to the application of public-private sector partnerships based on cost recovery pricing where this can practically and fairly be effected".

It is probable that most municipal engineers in South Africa believe that water supply and sanitation services are natural monopolies which should be undertaken by a public sector agency, and few have ever needed to consider how they might administer a private sector system such as delegated management. But this is slowly changing: local professional magazines such as "Water Sewage and Effluent" have raised the profile of PSP, but, as we know, local government officials, quite rightly, as those entrusted with the best interests of the community, will not easily change tried and tested approaches unless they are completely convinced of the benefits that will follow.

Mindful of the dangers of municipalities entering into poorly conceived long term arrangements for PSP, the Minister of Water Affairs issued his own interim guidelines. These lay down some basic principles including the need for transparency, competition, consultation and full coverage; plus other policy goals of Government such as employment equity, economic empowerment and soil conservation.

The banks, both commercial and the DBSA, are keen to see water supply and sanitation services operated and maintained in the most efficient manner possible. The service backlogs are enormous, the need for rapid development is self-evident, and there is no room for badly conceived investments or poorly run services. Those who are being asked to invest in public infrastructure will be demanding competent management which is responsive to customers, responsible with its investments and able to remain financially viable so that loans are repaid and services do not deteriorate.

There are also, however, important voices of dissent and reservation. Chief among them is that of municipal workers' unions. They are naturally concerned about the potential loss of jobs that are thought to follow a private sector take-over. They have declared their opposition to "privatisation", saying that the private sector only wants to make a profit and will not participate in the upliftment of people.

## **CREATING AN ENABLING ENVIRONMENT ▲**

PSP is not an end in itself, nor a single solution to all problems. It is one of several items which must be addressed in a developing country environment in order to meet every citizen's needs for improved infrastructure.

- There is the need for regulatory and enhancement measures to encourage private sector investment. The Department of Finance has initiated work on the various items needed to create such an enabling environment. These include a review of municipal accounting and reporting systems to ensure that prospective financiers can assess a municipality's financial standing, and a review of regulations governing borrowing powers. And an inter-departmental team is working on the grant component of the Municipal Infrastructure Investment Framework (MIIF). Both these and the regulatory framework should be produced soon in order to facilitate local authorities' access to both government grant funds and private sector finance.
- There is a need for rational long term planning, especially when it comes to the choice of level of service (LOS) and the speed at which backlogs can be addressed. To enable municipalities to do this properly, DBSA and the Water Research Commission have funded the development of a computer-based financial modelling tool to test, in detail, proposed investment plans in order to establish their long term financial viability. It is an interactive tool for the use of town engineers, treasurers and councillors, and prospective financiers. It enables municipalities and other service suppliers to model their needs and demonstrate their ability to repay loans, and to understand the political choices that must be made.

- There may well be considerable efficiency gains from moves towards more private sector participation in municipal services, which in turn could make it easier to raise finance. The DBSA has geared up to provide local authorities with the necessary advice and assistance to consider their options in PSP and prepare appropriate contract documentation. In general, there is a range of options for improving the performance and "borrower attractiveness" of local government utilities, but each of these should be firmly based within the local authority context of clear accountability to consumers.
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## **CONCLUSION ▲**

South Africa is moving towards the point where the merits and constraints of PSP are sufficiently well understood to allow a well-reasoned choice of the approach to be followed. It is imperative that the regulatory mechanisms, planning processes and institutional arrangements to streamline this, be developed as a matter of priority.