

March 2018

BUSINESS CASE FOR THE ESTABLISHMENT OF AN INDEPENDENT ECONOMIC REGULATOR
SUBMISSION BY BUSINESS UNITY SOUTH AFRICA (BUSA)

INTRODUCTION

BUSA welcomes the opportunity to engage on the Business Case for the establishment of an independent economic regulator for the water sector and wishes to present some preliminary views.

Views are preliminary at this stage because the status of the document is not clear. It is noted that the Chief Directorate have developed the document: economic and social regulation and some sections appears to be a branch of a department making recommendations to the department in which it exists. This implies that not even DWS has consensus on the document let alone other departments including National Treasury. It is therefore assumed to be a thought starter for engagement with external stakeholders before progressing the document through the necessary administrative and legislative process. Status should therefore be clarified.

PROBLEM STATEMENT

It is correct that economic regulation is required, particularly when state institutions dominate the market as is the case in respect of the water sector in South Africa. However, the challenges which the economic regulatory function seeks to address are cause for concern as they appear to go beyond what would normally be the scope of an economic regulator/ It appears as if the Department is attempting to place a number of its current regulatory functions under a new entity, which will result in additional costs.

Comments on the problem statement are presented below:

CHALLENGE	COMMENT
Insufficient investment in maintenance, refurbishment and replacement of infrastructure.	An economic regulator will not necessarily address this. Consider an approach which requires all water service providers in whatever sphere of government to include funding for maintenance and replacement of assets in their cost recovery tariff.
Poor management of services – interrupted supply, water quality, etc	This would normally be managed through licensing conditions and the withdrawal of the license if there is noncompliance. This could already be done by DWS in terms of their regulatory powers.
High levels of unaccounted for water – theft, wastage, unbilled.	BUSA has consistently argued that at least the physical losses be regulated through water use licenses with no success.
Areas still unserved, particularly in sanitation.	This can also be regulated
Weak tariff setting and billing.	Tariff setting, and billing are not the same challenge. These can however both be regulated through a license.
Value for money in use of Municipal Infrastructure Grant and Equitable Share.	The grant funders must enforce value for money when they provide funding
High levels of debt: national and provincial government to local government water services; (between local Government to Water Boards; Water Boards to the Department) and between the Department and the raw water users.	This will not be solved by a regulator. Electricity has an independent regulator and has the same problem

Comments on the case for change are presented in Annexure 1.

Comments on the gap analysis are presented in Annexure 2.

In the light of the fact that the status of the document remains unclear and the fact that there is no compelling argument for the establishment of a new entity to take over functions of the Department by at additional cost to the fiscus with no demonstrated value addition, BUSA has not reviewed the remainder of this document in detail.

CONCLUSIONS

BUSA recommends that the challenges with the document identified above be addressed as part of a preliminary socio- economic impact assessment, as required by DPME be undertaken before more developmental work on this project is undertaken.

BUSA also does not support the establishment of new state entities until the promised review of current SOEs has been finalised and recommendations implemented.

2.2 Case for change

Current Situation	Challenge	Benefit	Comment
Lack of financial sustainability of water institutions	<ul style="list-style-type: none"> - Reduced revenue collection - Increased Debts - Insufficient cost recovery 	<ul style="list-style-type: none"> - Improved collection of the tariff - Reduced debt 	A regulator will not necessarily fix this. Electricity has an independent regulator and it has not helped Eskom to be financially sustainable
Decreased levels of affordability	<ul style="list-style-type: none"> - Non-payment for water services - Requirement for cross-subsidies - Increased grants and subsidy funds from Government 	<ul style="list-style-type: none"> - Use of market-oriented techniques - Incentivise the use of low-cost technology 	There is no reason these benefits cannot be realised without a regulator
Low revenue collection for services	<ul style="list-style-type: none"> - Disputes on billing errors - High water losses within the networks 	<ul style="list-style-type: none"> - Improved performance monitoring 	More than performance monitoring is required to address these challenges
Unfunded mandates and directives	<ul style="list-style-type: none"> - Misappropriation of funds - Implementation of projects beyond the water sector scope 	<ul style="list-style-type: none"> - Cost benefit/ value (social & economic) analysis - Funds used on planned projects (promotes assessment & transparency) - Informed decision-making 	Same comment as above for Eskom

Current Situation	Challenge	Benefit	Comment
Underinvestment in infrastructure	<ul style="list-style-type: none"> - Insufficient revenue collection - Budgets allocation for Infrastructure O&M not prioritised - Improper strategic asset management - Inability to cost the operation, maintenance, and refurbishment of the infrastructure 	<ul style="list-style-type: none"> - Improved performance monitoring & Accountability by Management 	All of this can be achieved without a regulator
Access to basic services and the progression in levels of service	<ul style="list-style-type: none"> - Insufficient revenue collection - Citizens protests - Services below required standards (low service standards) 	<ul style="list-style-type: none"> - Improved monitoring - Incentivise the use of low-cost technology and cost saving measures 	Access to basic services can only be addressed through prioritisation at a political level and at a municipal level
Lack of understanding of HDI and indigent allocation	<ul style="list-style-type: none"> - Insufficient information provided to the HDI beneficiaries 	<ul style="list-style-type: none"> - Improved regulation 	Lack of understanding will not necessarily be addressed through a regulator
Price capping and under recovery	<ul style="list-style-type: none"> - Affordability - Promotion of economic development - Promotion of social imperatives 	<ul style="list-style-type: none"> - Use of market-oriented techniques to determine different types of assistance 	This is not the task of an independent regulator for water services
Operational inefficiencies	<ul style="list-style-type: none"> - Stagnant revenue returns - Worsened liquidity 	<ul style="list-style-type: none"> - Develop appropriate tariff packages 	A regulator does not necessarily address operational inefficiencies.

2.3 Gap analysis

STATUS QUO	AN IDEAL EFFECTIVE REGULATOR	GAP	COMMENT
The regulator has difficulty in recruiting & retaining highly skilled technical staff	<ul style="list-style-type: none"> - Ability to attract and retain competent, highly skilled personnel from the market. 	Skills gap	This cannot be solved by a new entity, therefore, the root causes of the current skills gap should be identified and addressed. It does not require a new entity.
Funded from fiscus and/ or water charges Unfunded mandate	<ul style="list-style-type: none"> - Funding levels should be adequate to enable the regulator, operating efficiently, to effectively fulfil the objectives set by government, including obligations imposed by other legislation. - Funding is either through levies or licenses or an independent budget line from National Treasury. - Funding processes should be transparent, efficient, and as simple as possible. 	Funding gap	BUSA cannot support additional funding from the fiscus to fund functions which should have already been undertaken by DWS. This is particularly a concern given the current state of the fiscus.
The status quo currently the NWA and WSA do not cater for the establishment of an independent regulator	<ul style="list-style-type: none"> - The establishment of the regulator will be aligned to promulgation of amendments to and or new legislation for the water sector to enable the independent regulator to be effective (it requires establishing legislation). 	Legislation gap	Much more compelling motivation should be provided before legislation is contemplated.

STATUS QUO	AN IDEAL EFFECTIVE REGULATOR	GAP	COMMENT
<p>There is no clear separation of the roles of custodian, policy maker, shareholder, supporter, and regulator.</p>	<ul style="list-style-type: none"> - Regulatory administration and decisions are fair, objective, impartial, consistent, and expert, without having any conflict of interest or bias, improper influence or improper purpose, or circumstances that reduce the regulator's market credibility, consistency of decision-making, or availability of expertise. - Clear separation between the institutions that provide support and the regulator 	<p>Credibility</p>	<p>There is no motivation as to why this separation is required</p>
<p>The Minister has entities reporting organisations, which is unmanageable-the arrangements need to change.</p>	<ul style="list-style-type: none"> - The reporting line of the regulator should be to parliament/ DPE and not the DWS ministry, to avoid conflict of interest 	<p>Conflicting reporting lines</p>	<p>There is evidence of the unmanageable situation</p>