

**DEPARTMENT OF WATER AFFAIRS
PRICING, ECONOMIC REGULATION REFORMS (PERR) PROJECT**

**(Pricing Strategy, Development of Infrastructure Funding Model and the Establishment of
Economic Regulation)**

Minutes of a meeting of the Pricing Strategy Work Stream

Date: 22 June 2012
Time: 14:00–15:25
Venue: Centurion Lake Hotel, Centurion

Present:

Department of Water Affairs

Bofilatos, E
Korommbi, K
Lemekwane, R
Machedi, NS
Mbele, N
Morodi, C
Moshidi, MSN
Mqina, T
Sekgothe, P
Sigwaza, DP (Chairperson)
Van Rooyen, JA

Stakeholder representatives

Stadler, O	Bloem Water
Mofakeng, PA	Department of Agriculture, Forestry and Fisheries (DAFF)
Senefeng, HT	Magalies Water
Chimuti, S	National Treasury
Matji, P	National Treasury
Ngobeni, V	National Treasury
Ncobela, L	Rand Water
Nyembe, M	Rand Water
Nyandoro, T	Rand Water
Moraka, W	South African Local Government Association (SALGA)
Botha, M	South African National Biodiversity Institute (SANBI)
Motsamai, MI	Sedibeng Water
Nteo, T	Sedibeng Water
Kristiah, A	Umgeni Water
Singh, K	Umgeni Water

Professional service providers (PSPs)

Madinginye, TDS	Pegasys
Mtsweni, A	Pegasys
Schreiner, B	Pegasys
Arnold, R	Write Connection (Scribe)

Apologies:

Gabriel, M-J DAFF

1. OPENING, WELCOME AND PURPOSE OF THE MEETING

Ms Sigwaza chaired this inaugural meeting of the Pricing Strategy work stream in the absence of a work stream chair. She explained that the Pricing Strategy work stream would have been chaired by Mr F Ishmael (Acting CFO: Water Trading Entity), who had asked to be excused from this role in order to focus on his responsibilities at the Water Trading Entity. This work stream would be supported by the Department of Agriculture, Forestry and Fisheries (DAFF). Ms Mary-Jean Gabriel would represent DAFF on the work stream, and Ms Mofakeng was standing in for her at the present meeting.

Ms Sigwaza asked Mr Mqina to ensure that either the chair or deputy chair was available for future meetings.

Action: Mr Mqina

The chairs of the work streams would meet.

Action: Project Management Office, Work stream chairs

2. INTRODUCTIONS

Introductions were not necessary, as most of the members of the Pricing Strategy work stream were also members of the Funding Model work stream, which had met earlier that day.

3. COMMUNICATION

This item was not discussed, as it had been addressed in the Funding Model work stream meeting earlier that day, attended by members of both the Pricing Strategy and Funding Model work streams.

4. WORK STREAM OPERATING RULES

This item was not discussed, as it had been addressed in the Funding Model work stream meeting earlier that day.

5. REVIEW OF PRICING STRATEGY SCOPE AND DELIVERABLES

Ms Sigwaza pointed out that as with the Funding Model task, the project steering committee (PSC) had requested that the Pricing Strategy task should consider the entire water value chain. The Pricing Strategy at present focuses on the raw water tariff, but the norms and standards for bulk water and water services were being revised and should be taken into account in addressing the task.

Presentation: Task 3 – Pricing Strategy

Mr Mqina presented Task 3, the Pricing Strategy task, as described in the terms of reference. The purpose of the task is to identify, evaluate and recommend a coherent and relevant raw water pricing regime for South Africa that balances the needs for cost recovery, sustainable financing and institutional viability with imperatives for redress, equity, growth, affordability and sustainability; and that enables effective infrastructure management and water governance, regulation and research. The task has five activities, and the key deliverable would be the finalised Raw Water Pricing Strategy.

Mr Mqina noted that the Minister was talking of a unified and standardised national water tariff, and the technical team should provide advice in this regard.

Activity 3.1 – Current pricing strategy gap analysis

- Review current pricing strategy success and failures and identify the key challenges, problem areas, gaps and opportunities for improvement

The abstraction-based water resources management charge has been established for over a decade, and the assumptions behind it require review, particularly related to the allocation of functional costs and the capping of charges on forestry and agriculture.

Activity 3.2 – Pricing principles

- The review of certain assumptions around institutional financing will depend upon the outcome of the institutional realignment process.
- Assumptions and procedures for estimating and allocating explicit or implicit subsidies needs to be reviewed, including:
 - A review of economic principles regarding water resource pricing
 - An analysis of international water pricing policies
 - Analysis of financing and economic regulation experience in other countries
 - Review of agricultural water pricing as an instrument to drive technical efficiency as well as economic efficiency of water use
 - Review of international water pricing subsidies and an analysis of the principles that underpin them
 - Review of international experience with pro-poor regulation and pricing in achieving equitable allocation of water.

Activity 3.3 – Develop pricing models

- Address the recovery of water resources management costs
- Assess the viability and self-sufficiency of catchment management agencies (CMAs), particularly in the context of amalgamation into nine CMAs. CMA funding models from user charges supported by fiscal transfers will be explored
- Develop and test relevant pricing models
- Explore the desirability of introducing water efficiency charges. (This would be investigated in the Economic Regulation task, chaired by Ms D Machotlhi, and there should be a relationship between that task and the Pricing Strategy task)
- Explore innovative trading and water auctioning mechanisms; these must be designed to support social and ecological imperatives
- Investigate the benefits and challenges associated with using national, system or scheme related tariffs; this will include an analysis of how to move from the current approach to a recommended approach
- Review the waste discharge charge system
- Develop an appropriate methodology for the pricing of water used in the generation of hydropower
- Review the assumptions and calculations for the Water Research Commission (WRC) levy

Mr Mqina noted that the key issues to be discussed include addressing acid mine drainage (AMD).

Activity 3.4 – Formulate Pricing Strategy

- The results will be translated into a revised Pricing Strategy, which will contain recommendations on:
 - Revised principles for pricing of raw water
 - Key elements making up the water tariffs and how they are to be calculated
 - Whether and where to use a national, systems or scheme tariff
 - How funding should be structured for full cost recovery
 - The principles for and elements of the subsidies
 - A simplified waste discharge charging model
 - How to price for hydropower generation
 - Tariff setting for infrastructure charges
 - The economic charge
 - The institutional implications of the Pricing Strategy

The outcome of this will be a draft pricing strategy to be gazetted for comment and consultation.

Mr Mqina commented that the development of a pricing policy would have to precede the Pricing Strategy.

Activity 3.5 – Evaluate socio-economic impacts

- Examine the potential social and economic impacts of the proposed approaches; an important aspect of this is again the equity and distributional implications
- Develop recommendation on how financing opportunities can be leveraged to support the shifting focus of water management

DWA would identify key sectors to be examined and key issues to be addressed in socio-economic assessment.

The report would be available before consultation with stakeholders. The socio-economic impact of the holistic pricing regime would be tested in the same locations used for the evaluation of infrastructure models in Task 2 (Funding Model task).

Mr Mqina raised the following issues for consideration in the Pricing Strategy work stream, which would have to make appropriate links with the Funding Model work stream:

- How CMAs are charged: whether user benefit from different services should be charged differently, or whether there should be a single water resource tariff across an entire water management area
- Whether there should be a national system or scheme charge
- Return on assets (RoA) related to public infrastructure: clear definition of RoA and consideration of the appropriate level of RoA for public infrastructure
- How the Pricing Strategy can be truly transformative and pro-poor
- Whether the Pricing Strategy should review the AMD tariff.

Ms Sigwaza added that other issues for the work stream to consider include:

- Whether to adopt the principle of cross-subsidisation
- Whether the Pricing Strategy task is a policy review or a strategy review.

Mr van Rooyen had been informed by letter that he was on the project steering committee (PSC) for the PERR project, and had received another letter informing him that he was also on the work stream. He had not been informed of the terms of reference for the PSC and work stream, or the role that was expected of him. He also sought clarification of the background to the decision on the areas on which the work stream should focus.

Ms Sigwaza responded that Mr van Rooyen was part of the technical resource team, and the Project Management Office would contact him outside the meeting to outline his role and responsibilities.

Action: Project Management Office

Ms Mofakeng (DAFF) noted that DAFF had been involved for some time in bilateral meetings with DWA, had participated in the DWA Water Pricing meeting held on 13 September 2011 and had had opportunities to make inputs to DWA processes. She was confident that the issues highlighted for the work stream to consider would address the problems that the agriculture sector is experiencing, but she asked whether issues such as whether pricing should be at scheme level could be discussed in detail in the work stream. Other issues to be accommodated would include bulk water infrastructure, since in some schemes DAFF is upgrading, refurbishing and maintaining infrastructure that belongs to DWA. Ms Mofakeng suggested that the water pricing in those areas might therefore need to be reduced.

Mr Matji (National Treasury) suggested the need to consider how best to focus on ensuring that the final document adds value to the challenge. He suggested the need to identify the weaknesses of the current strategy, the reasons why the expected revenue was not raised, and how this should be addressed. He commented that some of the activities would require considerable work to complete, and suggested the need to prioritise what was achievable, taking into account the challenges in the current strategy. For example, National Treasury considers AMD as a component of the environmental levy, rather than

singling it out for special attention. There is a need to adopt a principle on how South Africa will deal with AMD in all catchments (not just in Gauteng). Ordinary people could not be expected to pay for the AMD situation created by business; addressing AMD would require a partnership between government and business. National Treasury expected a policy position on how government would deal with environmental pollution as a whole, including AMD.

Ms Nyembe (Rand Water) raised the following issues for inclusion in the deliberations of the work stream:

- Context as an important starting point, especially the key principles not only of the Pricing Strategy but of the whole Pricing, Economic Regulation Reforms (PERR) project
- Pricing of the full water value chain
- Consideration of underlying aspects such as the principle of cross-subsidisation and whether components such as food security would be prioritised
- Key cost drivers in the context of full cost accounting (for example, taking the cost of energy into account) and strategies to reduce costs to the end consumer.

Mr Nyandoro (Rand Water) did not believe that return on assets (RoA) could form part of the work stream, as RoA was a factor of the entire economy. The expected RoA for water-related infrastructure would have to be based on the direction or mandate of National Treasury, and should not be prescribed by DWA. In determining the expected RoA, the types of assets and the markets they service should be taken into consideration (e.g. assets for poor communities would have to be considered in a different light from those that support economic activity).

Mr Moraka (SALGA) emphasised the need for common understanding of what the work stream would develop, particularly in light of the fact that the Pricing Strategy would be gazetted for public comment. The Pricing Strategy is a legislative requirement of the National Water Act, which relates only to water resources. Mr Moraka asked about the implications of developing a Pricing Strategy for the entire value chain, taking into account that some players in the value chain have a legislative mandate to determine their own pricing.

Mr Botha (SANBI) posed several questions to the project team:

- There was no mention in activities 3.2 and 3.3 of elasticity in pricing. There had been very little work on this in South Africa; Mr Botha was aware only of a small amount of such work in the domestic sector. He suggested the need for work on elasticity in the business and agricultural sectors, and enquired whether this would form part of the economic charge.
- Is there a link to a water conservation/water demand management (WC/WDM) imperative, which seems to be imposed on the water sector, and to what extent could pricing be used to achieve WC/WDM objectives?
- There is a need for a means to assess the return on investment of different options (since South Africa seems to have chosen expensive options thus far)
- It is rather restrictive to test the socio-economic impact of the holistic pricing regime in the same locations used for the evaluation of infrastructure models in Task 2 (Funding Model task), and there may be a need to test the impact in other places.

Mr Stadler (Bloem Water) noted that there were valuable aspects of the present Pricing Strategy model that should not be discarded, as shown by DWA's investigation of the impact of the model on water boards.

Mr Ngobeni (National Treasury) noted that Treasury had done research to determine the prices of the three legs of the water value chain, and had noted that the first leg determines the price of the third leg. The Pricing Strategy cannot be considered separately from regulation, as the strategy sends signals to the market. The current Pricing Strategy is not sending the right signals and needs to be reviewed in order to do so. For example, the National Treasury studies found that Mafikeng was charging relatively low water costs, despite the fact that the water board from which it gets its water was facing higher raw water costs. Mr Ngobeni suggested the need to place more emphasis on correcting the first leg of the value chain.

Mr Matji (National Treasury) noted that raw water prices could not be discussed in isolation, but water prices should be considered across the value chain, because the implementation of national projects affects tariffs to the end user. National Treasury had found that costs were much higher in areas that use TCTA's model than in other areas that are funded differently. Those costs are passed on to water boards and ultimately to users, including poor users who cannot afford the costs. There is a need to address the capital unit charge (CUC); how it is calculated, what informs it, whether it is the same in poor areas that implement schemes, and how to deal with this.

Mr Matji (National Treasury) noted that AMD would be addressed by the waste discharge charge system (WDCS), part of which is a tax. National Treasury had had a meeting with the PSP in order to understand the portion of the WDCS charge that is a tax and the portion linked to the tariff.

Mr Botha (SANBI) asked whether there would be an opportunity to calculate the costs at the raw water price to end users of an environmental rehabilitation or maintenance charge. He asked whether there was sufficient knowledge available to calculate such a charge (e.g. from the work supported by the Water Research Commission) or whether original research would be required.

Ms Sigwaza noted that the issues discussed would be incorporated into the Inception Report, which would be circulated to work stream members before 13 July 2012.

Action: Technical Team, Project Management Office

Mr Mqina responded to the comments of Mr Matji and Mr Moraka with respect to the project addressing the entire value chain and noted that municipalities and the Department of Cooperative Governance and Traditional Affairs (CoGTA) are represented on the PSC. He suggested that CoGTA should have nominated a representative to serve on the Pricing Strategy work stream. The issues raised would also be considered in the Economic Regulation work stream. He noted that Mr Moraka was serving on the Pricing Strategy work stream in order to assist in developing methodologies that would gain the support and buy-in from SALGA members.

Mr Mqina emphasised that the discussions in the work stream would not be limited to the points highlighted in the presentation but would take all the issues raised into consideration.

Ms Schreiner (Pegasys) agreed with Mr Matji that AMD should form part of the WDCS. She pointed out that although the Pricing Strategy task of the PERR project would do some work on the WDCS, there was a separate project on the WDCS, and there would be a need to ensure alignment between the two projects.

Ms Schreiner asked Mr Botha to elaborate on the environmental rehabilitation or maintenance charge that he envisaged. He responded that there would be a need to investigate opportunities for environmental charges at national or at catchment levels. Ms Schreiner noted that this could be considered as part of the Pricing Strategy. The raw water tariff is determined only at national level. Environmental charges could be considered at municipal level. Ms Schreiner suggested that the vastly extended scope of the project, to include water services tariffs, be discussed outside the meeting between DWA and the PSP. She expressed concern about how the change in scope of the project would be resourced.

Ms Sigwaza noted that the Project Management Office would communicate with the technical team outside the meeting to tighten the scope of the project based on the request of the PSC and the requirements expressed by the work stream.

Action: Project Management Office

Most of the issues raised would be included in the Inception Report, which would be circulated for comment.

Action: Technical Team, Ms Mbele

The next PSC meeting was scheduled for 13 July, and some work stream members were also members of the PSC.

Ms Sigwaza noted that engagement should continue between meetings. There would be a need to follow up with SALGA and National Treasury on other relevant studies and documents. She noted that the Pricing Strategy would be aligned with legislation pertaining to water services and water resources. A principle of the Pricing Strategy would be not to take over the powers and functions of other institutions. The Minister had undertaken to put in place a uniform and standardised national tariff by the end of December 2012, and the work stream would have to develop advice in this regard so as to respond as early as possible. She suggested that Ms Schreiner could assist in addressing this through her role on the Business Process Reengineering Committee.

Action: Work stream, Ms Schreiner

Mr Matji commented that the purpose of the Pricing Strategy task was to consider how best to correct the system, which might require legislative review. There is a direct relationship between the way schemes are funded at national level and the end-user tariff. In order to ensure that schemes are affordable and sustainable, any legislative blockages would have to be addressed. There is a need to ensure that people can afford the water that is provided. An enabling environment of cross-subsidisation could be created, but how to do so would be a challenge.

Ms Sigwaza noted that certain issues were being corrected. For example, Mr Sekgothe was working on the raw water tariff consultation process, and DWA was trying to establish the principle that National Treasury would be part of the raw water tariff determination process, in which they had not been involved in the past. A meeting would be convened with SALGA and National Treasury for that purpose.

Action: Project Management Office

In order to address the issue of not being both 'referee' and 'player', different DDGs would be responsible for the implementation of the raw water tariff and for the review of the tariffs. One of the problems encountered during consultation is that small farmers do not know where to go in the case of disputes with DWA, and the department was trying to address the process of raw water consultation. During the development of policy and strategy, implementation would be considered, particularly as it affects water boards.

6. TIMEFRAME

Ms Sigwaza referred to the proposed project timeframe, in terms of which the Pricing Strategy task was due for completion in September 2013.

With respect to the development of principles for the Pricing Strategy, Ms Schreiner clarified that the Inception Report would include principles that emerged from the international review, but this would be a set of but 'living' principles that could be revised and amended in the course of the project, since the principles would underpin all other aspects of the project.

Mr Mqina noted that the Minister had raised the possible need for policy review. Ms Schreiner responded that the policy would develop from the process and should not be determined up front.

Mr van Rooyen was concerned about the tendency for DWA to keep revisiting policy. The department has a National Water Resource Strategy, which was the result of the National Water Act and a water policy development process. His view was that the work stream should work with current policy, and that any need for policy review that was identified during the development of the Pricing Strategy should be addressed in a separate policy review process.

Ms Schreiner noted that the Inception Report would be delivered by 29 June. Dr Pegram had discussed the Inception Report with Mr Mqina and it had been agreed that the Report would include a high-level framework for the conceptual model for comment, discussion and input from the work stream. The conceptual model would be finalised by the end of July. Ms Schreiner clarified that the same conceptual

model would underpin both Tasks 2 (Funding Model) and 3 (Pricing Strategy), including institutional relationships, and funding and financial flows.

Action: Technical team

7. SCHEDULE OF MEETING DATES

The date of 3 August 2012 was proposed for the next work stream meeting, by which time the conceptual model would be available for discussion. However, Mr van Rooyen would not be available on that date. The Project Management Office would communicate with work stream members by email to advise them of a meeting date in the first week of August.

Action: Project Management Office

8. CLOSURE

Ms Sigwaza encouraged the work stream chairs, deputy chairs and technical resources to carry the project 'close to their hearts' and to read the documents so as to be in a position to engage.

The work stream chairs and deputy chairs would work closely together and lead future work stream meetings. Mr Mqina would follow up on a leader from within DWA for the Pricing Strategy work stream and inform the work stream in this regard.

Action: Mr Mqina

Mr Moraka (SALGA) requested that DWA stick to any dates for deliverables to the work stream so that members could ensure that they were well prepared. Ms Sigwaza responded that there were scheduled dates for the PSC meetings, but since the PSC was chaired at DDG level, the meetings might sometimes have to be rescheduled at short notice due to urgent commitments of the Minister.

Ms Sigwaza introduced Ms Sizani Moshidi, who would be joining DWA on 1 July 2012 as Director: Water Resource Finance and Pricing to replace Mohamed Vawda who had left the department.

The meeting closed at 15:25.

APPENDIX 1: LIST OF ACRONYMS

AMD	Acid mine drainage
CFO	Chief Financial Officer
CMA	Catchment management agency
CoGTA	Department of Cooperative Governance and Traditional Affairs
CUC	Capital unit charge
DAFF	Department of Agriculture, Forestry and Fisheries
DDG	Deputy Director General
DWA	Department of Water Affairs
PERR	Pricing, Economic Regulation Reforms
PMO	Project Management Office
PSC	Project Steering Committee
PSP	Professional service provider
RoA	Return on assets
SALGA	South African Local Government Association
SANBI	South African National Biodiversity Institute
TCTA	Trans-Caledon Tunnel Authority
WC/WDM	Water conservation/water demand management
WDCS	Waste Discharge Charge System
WRC	Water Research Commission

APPENDIX 2: ACTION ITEMS ARISING FROM THE PERR PRICING STRATEGY MEETING OF 22 JUNE 2012

	Task	Responsible party	Due date (where indicated)
1	Mr Mqina would ensure that either the chair or deputy chair of the work stream was available for future meetings.	Mr Mqina	
2	The chairs of the work streams would meet.	PMO, Work stream chairs (Ms Mathe, Ms Machotlhi and chair to be appointed for Pricing Strategy work stream)	
3	Mr Mqina would follow up on a leader from within DWA for the Pricing Strategy work stream and inform the work stream.	Mr Mqina	
4	The Project Management Office would contact Mr van Rooyen outside the meeting to outline his role and responsibilities on the project.	PMO, Mr van Rooyen	
5	The Project Management Office would communicate with the technical team outside the meeting to tighten the scope of the project based on the request of the PSC and the requirements expressed by the work stream.	PMO	
6	The Inception Report would take into account the issues raised by the work stream and would be delivered by 29 June 2012; it would include a high-level framework for the conceptual model.	Technical Team	29 June 2012
7	The Inception Report would be circulated to work stream members for comment.	PMO, work stream members	Before 13 July 2012
8	The conceptual model would be completed, including institutional relationships, and funding and financial flows	Technical Team	31 July 2012
9	The Minister had undertaken to put in place a uniform and standardised national tariff by the end of December 2012, and the work stream would have to develop advice in this regard so as to respond as early as possible. Ms Schreiner was asked to assist in addressing this through her role on the Business Process Reengineering Committee.	Work stream, Ms Schreiner	
10	A meeting would be convened with SALGA and National Treasury to discuss issues related to the raw water tariff determination process.	PMO	
11	The Project Management Office would communicate with work stream members by email to advise them of the date of the next work stream meeting, which would be in the first week of August.	PMO	