PUBLIC FINANCE for WASH

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# SOUTH AFRICA'S EQUITABLE SHARE FORMULA: A USEFUL MODEL FOR WASH FINANCING?

South Africa's Equitable Share formula is a mechanism for transfer of funds from central to local government, to support basic services including water and sanitation. This Finance Brief outlines how the system works, and reports on its use for water and sanitation. There are a number of problems with implementation of the Equitable Share in South Africa; however, we consider that the mechanism *per se* is good, and can be a useful model for other countries.

## THE EQUITABLE SHARE MODEL

Municipal governments in South Africa are responsible for the delivery of basic services, including electrification, housing, water supply, sanitation and waste collection.[1] Finance to provide these services can come from local taxes, from charges for services, or from diverse other sources of municipal revenue. In addition, municipalities receive budget support from national government: notably the Municipal Infrastructure Grant (MIG) and the Local Government Equitable Share (LGES). This Finance Brief focuses on the Equitable Share system, and its use for water and sanitation. Between 2003 and 2010, the Equitable Share was the largest central-to-local government transfer programme, accounting for on average 57% of all transfers to municipal governments.

## HOW IS THE EQUITABLE SHARE CALCULATED?

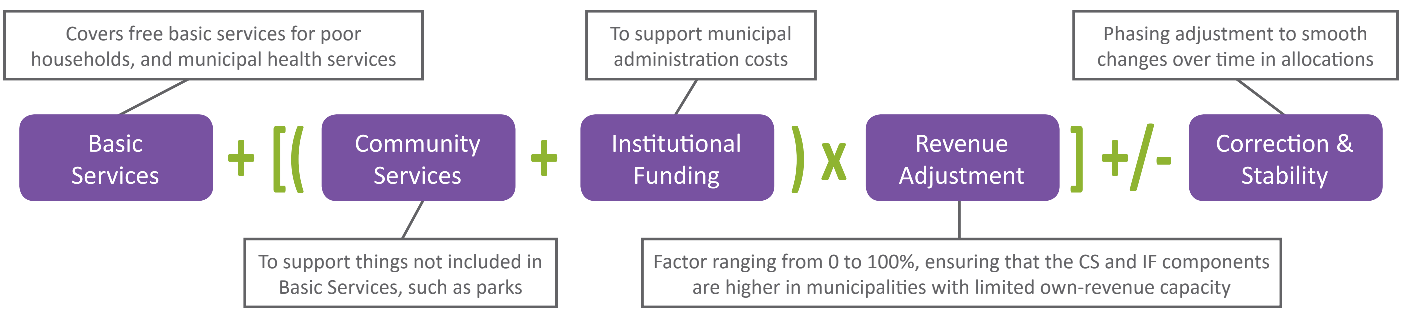
The Equitable Share formula divides a total fund (about US$ 2.7 billion in 2013) between South Africa's 278 municipalities. The formula determines the amount that should go to each municipality, as follows:[2]

The Basic Services component (about 75% of the total amount) is calculated on the basis of the most recent national census (currently 2011), allocating a "Free Basic Services" package of about 3300 Rand (US$ 265) per year for each household with a monthly income of less than 2300 Rand (US$ 185). Across South Africa, 59% of households meet this criterion; in other words, poverty is defined relatively broadly.

The Free Basic Services package of US$ 265 per household is nominally intended to be divided as follows: water 31%, sanitation 26%, refuse removal 22%, energy 21%. However, LGES grants are "unconditional", i.e. municipalities are (at least in theory) free to spend the amount as they choose.

## HOW MUCH IS SPENT ON WATER AND SANITATION?

A 2004 report[3] estimated that municipalities dedicate on average about 23% of their Equitable Share to water and about 12% to sanitation. Our own analysis of 2015 allocation data indicates that the average nominal allocation for water is 26% (range 10-56%) and for sanitation 21% (range 8-45%); in the



case of sanitation, this is substantially higher than in 2004. For a detailed analysis of allocation patterns, see NTSA (2012).[4]

We lack comprehensive data on actual expenditures on water and sanitation. A 2014 report indicates that *"discretionary spending of the Equitable Share grant means funding assumed under the National Plan to be allocated to the WASH sector can often be funnelled into other municipal priorities such as housing"*.[5] Analysis of published budgets from one particular municipality, Ugu District Municipality in Kwa-Zulu Natal (population about 720,000),[6] indicates that this municipality received an Equitable Share grant of 264 m Rand (about US$ 21 m) for the year 2015/16, of which about 142 m (54%) has been allocated to water and only about 5 m (2%) to sanitation. Within the 142 m for water, the allocation is about 13% to "*cost of supplying free basic metered water*", about 25% to "*free basic water - standpipes*", about 42% to "*water tariff subsidisation*", and the remainder to other water-related budget lines. This suggests that more is being used for blanket water tariff subsidy than for free basic water. And the allocation of only 2% of the grant to sanitation is striking. [*Nonetheless, this municipality should be applauded for transparent public reporting of budget; and we also note that we are here considering only Equitable Share allocations, not allocations from other sources including the Municipal Infrastructure Grant.*]

## CRITIQUES OF THE EQUITABLE SHARE MODEL

*The model encourages over-subsidy of water services?* South Africa operates a free basic water (FBW) policy, which essentially requires that households should not be charged for the first 6,000 litres per month. The costs of free provision are expected to be covered by cross-subsidy within the municipality, with support from national subsidy arrangements including the Equitable Share. This model has been praised as effective for achieving basic services: see the excellent article by Muller (2008).[7] However, some authors have raised concerns about reduced revenue collection leading to reduced service quality and system functionality.[8] And as noted in the previous section, it seems likely that there may often be over-spend on blanket water tariff subsidies, and under-spend on sanitation for poor communities.

*Municipalities lack capacity?* Some authors have reported that the Equitable Share application process is difficult, and challenging for smaller municipalities.[1] The model has also been criticised for being detached from the real-world operation and maintenance challenges faced by municipalities.[2] Many municipalities are reported to lack capacity to effectively spend and manage their Equitable Share grants.[9]

## HOW RELEVANT IS THIS MODEL FOR OTHER COUNTRIES?

South Africa is of course significantly wealthier than most countries in sub-Saharan Africa: GNI per capita is currently around $7400, versus an average of about $1700 for other sub-Saharan African countries (or for example $2700 in oil-rich Nigeria). Furthermore, the recent history of South Africa is very different from that of other African countries, and has led to a free basic services policy for communities that were deprived under apartheid. Related to this, it seems likely that too much of the Equitable Shares money goes to subsidising water for the not-very-poor, and too little goes to providing water and sanitation for the very poor. It would be useful to get better data on actual expenditure on water and sanitation, with detailed breakdown: for example how much is spent on tariff subsidy for free basic water, on sewerage, on onsite sanitation? But notwithstanding these uncertainties and implementation challenges, we consider that the Equitable Shares system is a progressive and essentially well-designed approach, which offers a very interesting model for other countries in Africa and elsewhere.

1 Koelble TA & LiPuma E (2010) Institutional obstacles to service delivery in South Africa.
2 Fanoe W (2013) New Local Government Equitable Share Formula and free basic energy.
3 Whelan P (2004) The Local Government Equitable Share.
4 NTSA [National Treasury South Africa] (2012) Local Government Equitable Share Formula Review - Discussion Paper 2: Analysis of the Current Local Government Equitable Share Formula.
5 Roux A et al. (2014) Market Intelligent Report. http://greencape.co.za/assets/Uploads/GreenCape-MIR-Water.pdf
6 Ugu District Municipality, budgets published online at http://ugu.gov.za/budget.aspx
7 Muller M (2008) Free basic water – a sustainable instrument for a sustainable future in South Africa.
8 ISF-UTS (2011) South Africa Water, Sanitation and Hygiene Sector Brief, prepared for AusAID. Institute for Sustainable Futures, University of Technology, Sydney.
9 LGA [Local Government Action] (2015) An Activist's Guide - Municipal Budget http://www.localgovernmentaction.org/activists-guide/key-processes/municipal_budget

**PUBLIC FINANCE for WASH**

The Public Finance for WASH initiative is grounded on two principles: i) that sustainable universal provision of high-quality water and sanitation services is fundamentally dependent on progressive domestic taxation systems, and that consequently ii) WASH-sector donors, donor-funded NGOs and in-country actors need to pay greater attention to ensuring that ODA is delivered in ways which support the development of effective and equitable domestic public finance systems.

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WSUP Water & Sanitation for the Urban Poor
IRC Supporting water sanitation and hygiene services for life
trémolet consulting infrastructure | economics | policy