

# **How can IFIs support increased financing for water and sanitation. The potential role of the FWG**

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# Trends in Financing (1)

## ■ ODA

- Very recent effort of IFIs to increase presence
- Attempt to leverage: risk mitigation instruments
- Coordination
- Regional, dedicated facilities

## ■ Public financing

- Low priority of sector in budgeting process
- Decentralisation, but with problems

## ■ Users

- Understanding of WTP, ATP is improving
- Subsidies are here to stay – Design, targeting

## Trends in Financing (2)

- **International private sector further withdrawing from WSS sector, esp. equity**
  - Crisis of confidence
  - Risk / return mismatch perception
  - Political economy, regulatory risk
  - Exogenous factors (crises, financial markets)
  - Imperfect data, inadequate contract design
- **Local PS role**
  - Interest in PSP, esp. from construction companies
  - But what about local financial markets / savings?

Source: J. Saghir, 2005

## Role IFIs

- Enable
- Finance More
- Finance Better
- Adjust Behavior

All steps help reduce risk and encourage (re-)entry

# ENABLE

- **The “Macro” level**
  - Affect exogenous factors
  - Water & social spending a priority in PRSP
  - Sector policies, institutional framework
- **Support local authorities & communities**
  - Access to financing / Voice
  - Capacity-building (technical, managerial, M&E)
- **Foster and disseminate knowledge**
  - Water & Growth, Subsidies, Local PSP, PPPs
  - Information about available instruments
- **Mitigate risk, especially sub-sovereign risk**

# FINANCE MORE...

- **Renewed focus on implementation**
  - Scaling up
  - Learn by doing (infrastructure AND reform)
  - Pragmatism
- **Multiple instruments**
  - Projects – choose the right ones
  - Programs – donor coordination
  - DPL – opportunities and risks
  - Risk mitigation instruments
- **Regional, sector-focused facilities**

# ...BUT FINANCE BETTER

- **Choose the right project(s)**
  - Multiplier effects and complementarities
  - Measurable benefits to the poor
  - Integrated approach & sustainability
- **Innovate where appropriate**
  - Technical solutions
  - Contractual solutions
  - Financing solutions: Tailor financing structure including risk mitigation instruments to match each project's risk profile
- **Coordinate, blend funds**

# ADJUST BEHAVIOR

- **Coordinate**
  - Donor coordination process
  - Program approach. Link DPL/projects
- **Be Flexible**
  - Coexistence of tailored approaches (no ideological preferences)
  - Operators' Roundtable recommendations
- **Be Accessible**
- **Be Daring**
  - Innovations when they serve the purpose
  - Less preoccupation with reputational risk

# An Example – EIB

- **Enable:**
  - Greater efforts in project preparation.
  - Policy dialogue, in coordination with other donors.
  - Transfer expertise, cross-fertilization from EU work
- **Finance more:** New push in ACP. Link with EUWF
- **Finance better:**
  - The right project: tailor, integrate, multiplier impacts
  - The right financial tools: IF funds can be used for equity, quasi-equity, guarantees and credit enhancement, FX risk coverage, interest subsidies, grants for project preparation
- **Adjust behavior:** Be accessible. Be daring?

# Why Focus on Innovation?

- Limited availability of grants and concessional financing
- These resources should be directed to those areas and activities that are least likely to have access to alternative sources of financing, even with DFI enabling
- Innovative financing mechanisms, particularly risk mitigation instruments, help attract additional financing to those areas where conditions are mature, thus freeing otherwise misallocated concessional funds
- A better match between the risk profile of a project and its financing structure increases its sustainability and the capacity to target the poor

# Potential Role of FWG

- **Knowledge center on existing risk mitigation mechanisms**
  - Exhaustive review of existing mechanisms
  - Identification of constraints for their use in different contexts
- **Provide practical examples of how some of these could be used**
  - In countries with more/less mature water and financial sectors
  - For projects in both water supply and sanitation
  - To define country strategies for WATSAN financing

# Proposed Activities for Phase 3

- **Knowledge centre**
  - Database on existing mechanisms & their use
  - Studies on tool families or specific tools
- **Project examples – Short-term activities**
  - May start from projects submitted to EUWF:  
Choose set that may benefit from fin. restructuring
  - Select 2-3 in coordination with Africa WSS WG
  - Represent a range of contexts and both WS & SAN
- **Country strategies – Long-term activities**
  - Select 2-3 in coordination with AWSS WG
  - Represent a range of contexts, but effective country dialogue is probably crucial

Thank you

- Many towns and municipalities in developing countries are constrained by a lack of access to loan-financing facilities. Because of their limited revenues from user fees and taxes, these communities often rely on transfers from central government to finance construction of improved water supply and sanitation networks. Transfers, however, are subject to fluctuations in the national economic and political climate, thus undermining cities' ability to undertake long-term water and sanitation planning.
- Many water and sanitation utilities are characterized by weak managerial and financial capacities. In many cases, political pressures prevent them from charging service prices that would cover recurrent costs, even in communities with the collective financial capacity to cross-subsidize service for the poorest. This, together with poor demand management and high levels of unaccounted for water, often make it impossible for utilities to generate sufficient cash flows for recurrent expenditures. As a result, their creditworthiness is weak, and they are unable to attract investment for expansion. Indeed, many water and sanitation agencies have difficulty funding proper operation and maintenance of the systems they currently manage, much less expanding services to keep pace with the rapid growth in their communities. Reliance on recurrent funding from state or national government for operation and maintenance is even more tenuous than that for construction. Thus, instead of moving toward financial self-sufficiency and universal coverage, agencies deliver subsidized service largely to their communities' wealthiest households that have more political or social influence. In other cases, financial regulations require that revenues from water supply are sent to national coffers and are prevented from being used for water supply operations and maintenance. Where such revenues have been ring-fenced for the exclusive use of the water supply agencies that collected them, significant improvements have resulted in

- Overly optimistic expectations from private sector investments are another constraint. Some developing-country governments are reducing national expenditures for water supply and sanitation with the expectation that the investment gap will be filled by the private sector. Recent evidence suggests that this attitude appears to be overly optimistic. After peaking in 1997, external private financial flows have decreased steadily during the past several years.<sup>6</sup> The features of investment in water and sanitation facilities—including its “lumpiness,” payback periods of 20 years or more, and political difficulty of charging cost-recovering tariffs—make it difficult to attract private investment. The frequency with which water and sanitation concessions in both developing and industrialized countries have been postponed or cancelled over the past several years is evidence of how difficult it is to design and implement successful private-sector involvement in water supply and sanitation services. And private sector investment does not go to the areas of greatest need (where coverage is lowest); it has been estimated that between 1990–97, less than 0.2 percent of all private sector investments in the water and sanitation sector of developing countries went to Sub-Saharan Africa.
- This decline has taken place against the backdrop of an ongoing and heated debate about the appropriate roles for the private sector in this area—a debate that has been polarized around conflicting ideological positions, especially around large-scale projects involving multinational companies. The cost of conflict generated a stalemate of sorts amongst stakeholders, with obvious consequences for the attainment of target 10, especially in middle-income countries. While there are signs that dialogue around private sector involvement has recently become less polarized, still-greater constructive engagement around this issue is needed; such engagement could be enhanced, for example, through an independent, balanced multistakeholder assessment of the impacts of public and private sector participation that would glean lessons from past experiences and enhance decisionmaking on service delivery options.

- Weak local financial markets constitute another constraint to the financing of improved access to water supply and sanitation services. As a result, there is a tendency to rely on financing that is denominated in foreign currencies. Yet revenues on which utilities and government would depend to repay such loans are denominated in local currencies. Such reliance on external financing is constrained by several risks, such as devaluation and liquidity risks associated with the low cash flows from utilities. The Report of the World Panel on Financing Water Infrastructure provides a number of remedial measures, such as special forms of international guarantees that can be used to address financing problems (World Panel on Financing Water Infrastructure 2003). However, a lot depends upon action by governments and utilities to increase their cash flows and strengthening their financial and managerial capacities.

- Trends in official development assistance indicate that support for water supply and sanitation infrastructure is very modest, both in relation to support provided to other infrastructure sectors and in terms of what is necessary to meet the Millennium Development Goals for water and sanitation. A recent report by the Development Co-operation Directorate of the Organisation for Economic Co-operation and Development shows that only 6 percent of total bilateral aid in 2001–02 went to the water sector and that only 16 percent of that water aid went to countries where less than 60 percent of population has access to an improved water source. Moreover, aid to water and sanitation is concentrated in certain countries, with the 10 largest recipients receiving 53 percent of the total. Support tends to focus primarily on the provision of urban infrastructure to middle-income countries (OECD-DAC 2004); yet, the greatest needs are in rural areas.
- Moreover, the prerequisite condition normally prescribed for official development assistance—that for effective and accountable use of such aid, certain reforms must be in place—has been a constraint to the countries most in need for help in meeting target 10. While recognizing the importance of such reforms, the task force believes that the alternative principle of pursuing reform and capacity strengthening simultaneously with investment, using the “learning by doing” approach, is more likely to help the weakest countries to meet target 10.

- One means to address the issues of inadequate financial resources; poor donor coordination; and shifting priorities to provide adequate, sustained financial and technical support for the achievement of the water and sanitation Goals would be through regional-level multilateral donor mechanisms. Regional water and sanitation facilities could provide funds for both sector investment and capacity building in the poorest countries. Just such a facility—the African Water Facility—is at an advanced stage of development and will be hosted within the African Development Bank. Some characteristics of the African Water Facility provide useful pointers for similar facilities elsewhere, including being housed in a regional bank with UN Regional Office support and liaison; access on a self-selection basis; and an approach that combines capacity building, reforms, and investments toward the achievement of the Goals for water and sanitation. Another option is coordinated donor programs instead of project-based funding.
- One of the most striking implications of the previous sections is that many of the constraints to improved access to water supply and sanitation services lie outside the sector itself. The inadequate financial allocations to water supply and sanitation services in most developing countries are the result of budgetsetting processes in which water and sanitation are pitted against any number of competing claims for limited resources. Lack of responsiveness and accountability in water and sanitation service provision often stems from broader civil-service legislation and the balance of power between central and local government, both of which are established at the national level. Governments that are committed to improving long-term access to water supply and sanitation services must, by extension, be prepared to make hard choices regarding budget priorities, the devolution of powers to local administrations, and the restructuring of incentives and accountability networks among the public, private, and civic sectors.

**It is time to work together**

**Let's Go Get Them!**