

COST RECOVERY: TAKING INTO ACCOUNT THE POOREST AND SYSTEMS SUSTAINABILITY

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ABSTRACT: This paper focuses on financing and cost recovery for the drinking water sector in rural and low-income urban areas. Governments, development agencies and communities in different parts of the world are struggling with the issue of decentralization and cost recovery. Few countries have realistic policies, operational strategies or plans for cost recovery and sustainable financing for increased service coverage, particularly for the poor. Community organisations, municipalities and small service providers are failing to generate the revenues needed for either investments to meet growing demand or the daily operation and maintenance of existing systems. All of these groups are in need of guidance and support, in the form of policy and institutional models based on real experience, to develop appropriate financing and cost recovery mechanisms. Due to the lack of such systematic knowledge, strategies for cost recovery are typically short sighted, address only part of the issue of sustainability (for instance, focusing solely on operation and maintenance costs), and result in degradation of systems and failure to deliver reliable water supply and sanitation services. But how, and who will pay? And how to do we ensure that poverty is properly addressed?

KEY TERMS: financing, decentralization, poverty, water systems sustainability, rural and low income urban areas

INTRODUCTION

Drinking water programmes and projects are known to bring wider benefits to communities in the form of health, opportunities for women (Bhatt et al., 2002) and poverty reduction. Given the overall societal gains that can be achieved, water and sanitation services should be improved, especially for the poor. However, in spite of all efforts, the absolute number of people without improved water supply and sanitation services remained practically the same in the last 10 years, and the majority of the people without services are those living in rural or peri-urban communities (WHO/UNICEF 2000). Furthermore, during the 2nd World Water Forum and other sector meetings, it has been recognised that cost recovery is still today one of the major obstacles towards sustainable drinking water (IRC – International Water and Sanitation Centre, 2001a).

With current rates of population growth, competition for a scarce resource and aging infrastructures, access to drinking water services poses a considerable and growing challenge in developing countries. The financial challenge is particularly acute, largely due to lack of institutional and administrative management capacity at district and regional levels added with an increasing pressure from support agencies and governments for no-free water (IRC, 2001b).

This document describes IRC's and some of its partners' approach to financing and cost recovery for the drinking water sector in rural and low-income urban areas, in the context of decentralization and sector reform. It also discusses knowledge gaps and research challenges for the coming years.

DECENTRALISATION AND COST RECOVERY

It is expected that the adoption of decentralisation policies in developing countries will contribute to reducing over-concentration of power, authority and resources at the level of central government. The aim is achieving a greater equity in the allocation of resources, with increased efficiency, effectiveness and sustainability of water services. In the context of sector reform, policies and strategies regarding cost recovery are based on the premise that water is an economic as well as a social good (WMO 1992), and that water services have a price that consumers should pay.

However, a major consequence of decentralisation is that it increased the financial, operational, technical and managerial responsibilities at the local level, which local governments and communities sometimes did not have the capacity to meet. Many of the factors explaining the failure to adequately cover the costs of improved services in developing countries reflect this situation: unclear and inappropriate cost recovery strategies and policies for rural and low-income urban context; low efficiency of existing financial management systems; existing cost recovery principles rarely taking into account gender and

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equity objectives; poor willingness and ability to pay (especially in the context where water services have been provided free of charge); problems of cash flow; low access to alternative financing; poor management capacity (at community and district/regional level); misuse of funds and political interference (Brikké & Rojas, 2002).

FINANCING AND COST RECOVERY FOR SUSTAINABILITY

In the context of IRC's and its partners work we see cost recovery being the matching of *all* costs related to providing a *sustainable service*, with *all* the available sources of funding (Figure 1). These funding sources may lie entirely with the users, but may also include external funding from governments or donors. The crucial point is that unless all the costs related to providing and maintaining a service (technical, human resource, institutional) are identified and covered a system cannot be considered to be sustainable.

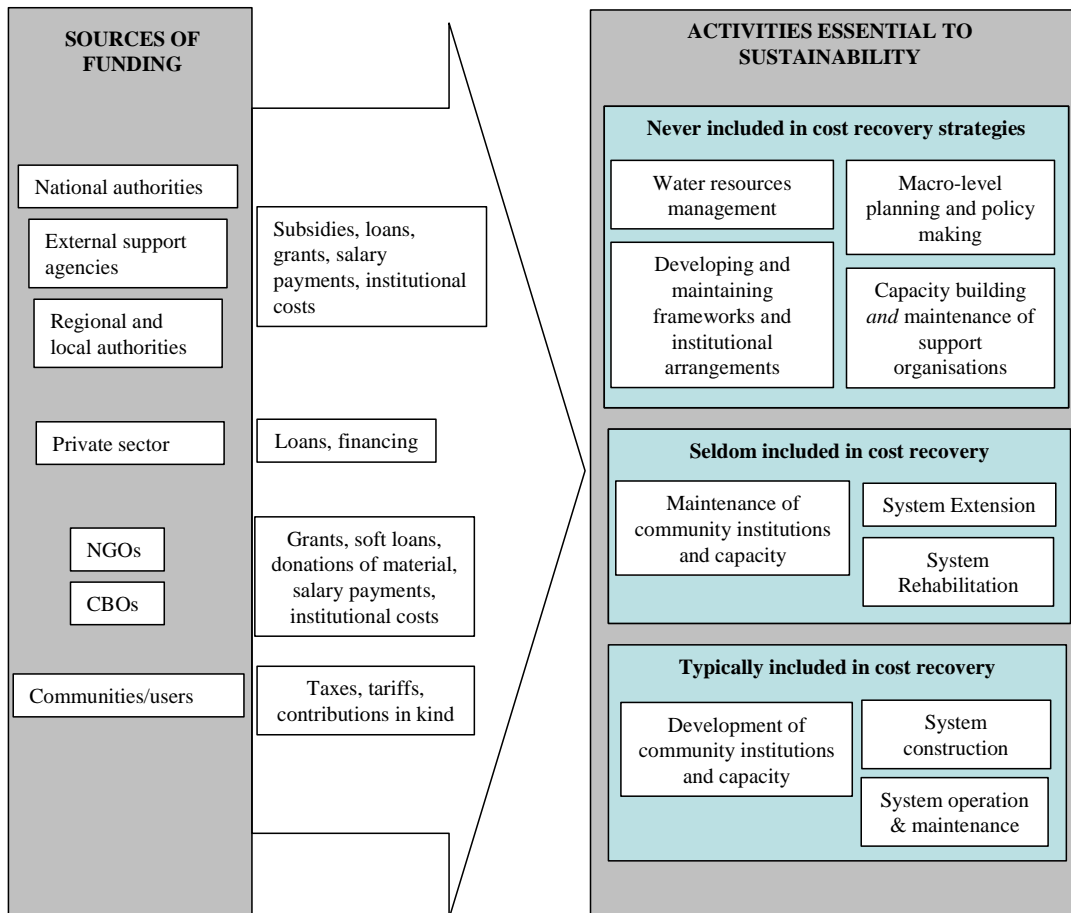


Figure 1. Sustainability requires the matching of ALL costs related to providing a sustainable service, with ALL the available sources of funding

In rural and low-income urban areas *user based* cost recovery strategies become crucial as communities are progressively made responsible or co-responsible for the financial management of their system. Making communities responsible has proven to be an effective strategy for achieving sustainability in operation and maintenance of systems (IRC, 2001b; Bolt & Fonseca, 2001). However to date, such responsibility has typically been limited to funding of system management and O&M costs with, in some cases, a minor contribution to capital costs. Inclusion of the capital costs related to system construction, enlargement or replacement, as well as for the necessary institutions to support community managers requires different models. Such models will also be crucial to replicating community based management models across entire districts or regions. In particular models will shift from looking at the financing of individual systems in isolation to that of service provision to entire populations.

IRC approach to cost recovery therefore aims to look beyond the three year horizon of most projects or programmes financed by support agencies. It also aims to look beyond the individual water system and its users. It considers not only the construction, but the lifetime, rehabilitation and extension of water supply systems and all the elements that are necessary to providing longer term support to users in rural communities and urban neighbourhoods. Key items to be considered in this approach include:

- tailoring of cost recovery frameworks to the special needs of the rural and urban poor (seasonal/irregular payment, payment in kind, etc.)
- developing frameworks for transparent cross subsidisation of capital and recurrent costs, with a focus on ensuring coverage of the poorest of the poor;
- developing institutional arrangements and legal frameworks that ensure that money from cost recovery is used for service delivery;
- identifying mechanisms for including in cost calculations, the development and maintenance (and capacity) of the institutions to support communities in managing their systems e.g. initial and repeat training, auditing, technical back-up etc;
- identifying financial mechanisms to encourage demand management and avoid resource depletion;
- including in cost recovery those costs related to waste water management;

Best practices reflecting the above mentioned points are available from some countries and regions in the world (IRC, 2003).

KNOWLEDGE GAPS AND RESEARCH CHALLENGES

Cost, Payments and Structures

The approach presented raises many, yet non-answered, questions. Most important are those related to achieving full cost recovery of total service delivery costs. Practice has shown that contributions by the users to O&M costs are (particularly in the early years of a systems life-span) reasonably easy to raise. They are also relatively easy for communities to deal with. Contributions to capital and replacement costs (and also to costs of more major repairs needed as systems age) are more difficult. Even modest one-off contributions to capital costs have in some cases indebted communities to the extent that once the system is built, they cannot afford the maintenance costs. Yet often such contributions tend to be trivial in comparison to total capital costs (varying from 5% in much of Africa, to as high as 50% in parts of Asia). Closing the gap between limited payment for O&M and all the costs related to sustainable service provision remains the challenge. But there are many questions that need to be answered:

- Who pays what expenses? Water services have a price, but what can we realistically expect from rural communities? What should be paid by the communities/users and what should be paid by the government or subsidised by other users/uses?
- How can it be done? Which policy instruments exist at different levels to ensure that all the costs are taken into account and met? Which tools can be used for estimating the different costs?
- How can large capital costs be integrated into manageable tariff systems rather than be dealt with as un-manageable one-off payments at project inception?
- How much does it cost to provide long term support to communities. What does it really cost to provide sustainable water and wastewater services in rural and peri-urban areas?

Existing models often rely on 'data' coming from un-critical case studies. There is a need to identify and document rigorously and externally evaluated case studies that identify successes, but also failures, constraints, and challenges.

Equity in Service Provision

Water provision services must have a realistic price that consumers should pay, but the level and means of financing should be such that everyone can use safe water for their primary needs (drinking and personal and domestic hygiene). There are many examples of levels and means of financing that impede these basic human rights (Wijk, 1998), for example communities where construction and maintenance costs have been fully recovered but where only the better-off are being served. There is also worrying anecdotal evidence that where costs are raised too high the poorest return to using unsafe alternative sources (Rall, 2000). These last examples illustrate well the dangers of a narrow financial approach to cost recovery that ignores the broader economic issues such as improved productivity, due to reduced morbidity related to water born disease. There are a number of important questions surrounding the issue of equity in service provision that must be addressed, notably:

- How to maximise the amount paid by consumers taking into account poverty? A question which with the increasing involvement of the private sector becomes even more pressing.

- How to translate the costs of building and maintaining a system into equitable tariffs and flexible choices to the communities?
- With increased pressure to pay for water how to prevent people from going back to unsafe alternatives or dangerously reduce water use?

Even as debates continue over the inclusion of cost recovery policies and practices in the water sector throughout the world, poor people in developing countries on average pay more per litre of water than the wealthy – for a lesser quality supply (Webb and Iskandarani, 2001). Thus, the argument that the poor are unable to pay is not true in every case, leading to the conclusion that cost recovery principles taking into account poverty can be a viable option to improving service delivery (IRC, 2003).

CONCLUSION

There are no “best practices” for cost recovery, or management structures that can be replicated to ensure that the system will function optimally during 30 years. Rather, projects and programmes with successful financing and cost recovery strategies tend to share common principles which have been found to contribute to sustainable systems (IRC, 2003; Fonseca & Bolt, 2002).

While there is some agreement within the sector that consumers have to pay for water, methods and tools for ensuring access to improved services by the poor remain highly debatable while many of the above mentioned knowledge gaps still remain to be properly addressed. Tackling these problems and translating validated principles and procedures into guidelines and capacity development tools needs an urgent and concerted effort.

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