



# Financing the water sector

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**If we are ever to reach the millennium development goals, much greater levels of finance will need to be raised, and sound systems of governance should be in place to manage them.**

Back in the 1990s, the topics of ‘finance’ and ‘water’ rarely converged. By and large, in rural areas, donor agencies provided grants for rural systems. In urban areas, the government (with support from donor agencies) subsidized water and wastewater utilities, and the development finance institutions sought to increase the participation (through capital investments, and operations and maintenance) of the international private sector.

However, with the advent of the Millennium Development Goals (MDGs) and increased attention to the water sector at a global level, the need for understanding finance at all levels (global, regional, national and community) gradually became apparent. At Bonn (The International Conference on Freshwater) in 2001, participants came to the realization that supplying clean water to people, at the scale required to achieve international targets, would require more than laying some pipes. Issues such as policies, reforms and institutional and economic issues relating to finance appeared, and financing finally became a priority.

## The Camdessus Report

Launched at the Third World Water Forum, the *Camdessus Report*<sup>1</sup> codified what was known about finance for the water sector, including recommendations on how to access new sources of finance. The *Camdessus Report* stressed the importance of attaining internationally agreed water targets and indicated that all sources of finance should be tapped, calculating that achieving the MDGs would require a doubling of existing finance. It added that a pre-requisite for achieving these targets would be an improvement of the

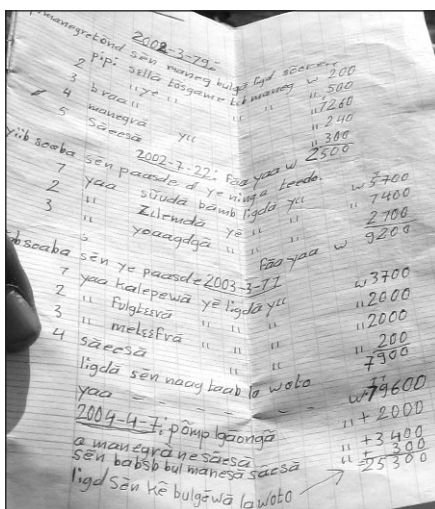
sector governance, better cost recovery and some national public funding. The choice between public, private or Public-Private-Partnerships (PPPs) to finance the water sector was left to the countries.

When the *Camdessus Report* was first published at Kyoto there were very public protests. The Camdessus key messages were that financial flows needed at least to double and that sustainable cost recovery was central to this aim. However, the report emphasized large-scale infrastructure and financing water services in urban areas. Most of the critics accused the report of missing the point by ignoring financing options to reach the poor, most of whom live in rural areas.

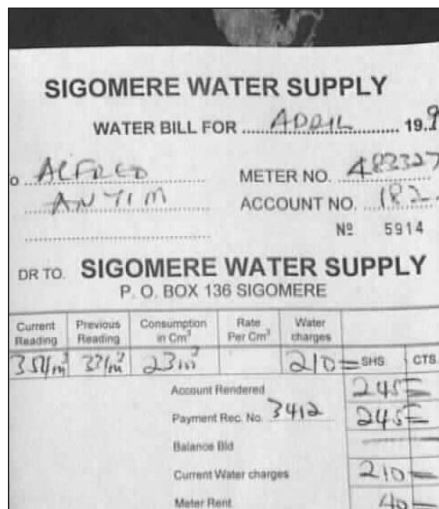
While the *Camdessus Report* put the issues relating to finance in perspective, it did not go into detail on the types of financial instruments that could be used by different actors (e.g. bonds, loans, equity, guarantees, subsidies, etc.), nor

did it address the following fundamental question facing the sector: how can a poor country access the necessary capital for water and sanitation investments?

Since the *Camdessus Report* was launched, other processes have worked to fill in some of the gaps. In a recent overview, estimates for the total amount of funding required per year to achieve MDG Target 10, to halve by 2015 the proportion of people without sustainable access to safe drinking water and sanitation, range between US\$6.5 billion and \$75 billion.<sup>2</sup> Many finance mechanisms are available to meet this financing gap; unfortunately, most efforts are being targeted towards developing and promoting external resources that are more suitable to middle-income countries. In response, a report by the MDG Task Force on water supply and sanitation noted that targeted grants should be provided for use in the poorest countries to bridge the finance gap.<sup>3</sup>



Cost recovery in rural areas – here in Burkina Faso each water account is based on the number of household members



Cost recovery in peri-urban areas – this bill from Cameroon is based on metered water consumption



Water is sold by the bucket from this community water tank – payment is made to a caretaker

The EU Water Initiative's Finance Working Group (FWG), which provided considerable inputs during its first phase (2003) to the Camdessus Report, and which receives ongoing support from the UK's Department for International Development (DFID), was created to address financial issues facing the water sector. Its objective is to support the EU Water Initiative, which shares the same goals as the MDGs. The FWG includes over 40 organizations representing the public, private, NGO and civil society sectors in both an international and domestic context.

After a second phase (2004), the FWG released a final report<sup>4</sup> and over 50 background documents, which go beyond the Camdessus Report to address the following questions:

- Why do the current financing flows not reach the water sector?
- What constraints affect these finance flows and how could these constraints be overcome?

### Different levels of financing

The report's key findings point to the importance of finance at international, national and local levels. At international levels, constraints imposed by donors and development finance insti-

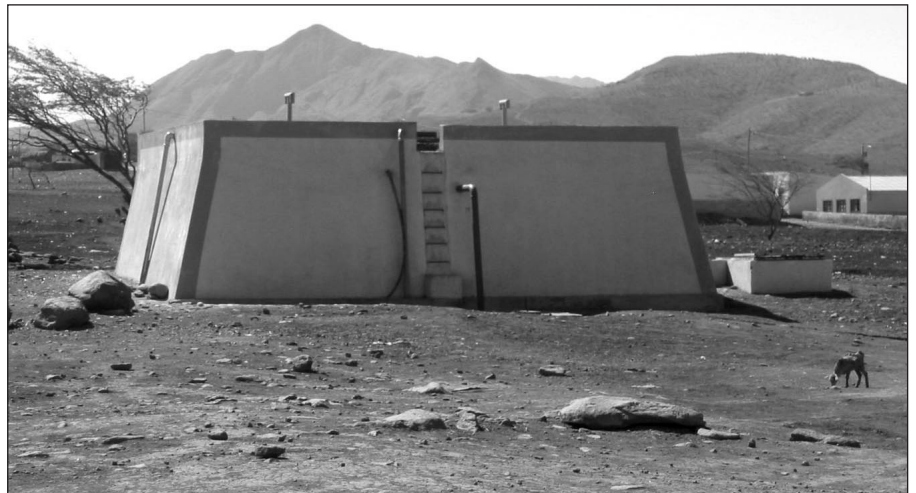
tutions need to be addressed. Medium-term expenditure frameworks and public financial management (including public expenditure reviews) linked with Poverty Reduction Strategy Processes (PRSPs) may help to rationalize public sector finance. At sub-sovereign levels, support for mechanisms such as municipal bonds and other forms of sub-sovereign finance should be promoted where possible, along with locally sourced finance through community-based solutions. Still, while PSP may help to leverage international expertise, and project preparation facilities may

help to develop larger infrastructure projects, capacity building for sub-sovereign decision-making remains a key challenge and constraint to the sector, and needs new thinking, solutions and financing.

### Country-level finance mechanisms

Since 2003, the IRC Thematic Group on Financing and Cost Recovery has been collecting data on country-level finance mechanisms, on the assumption that financing water to meet the needs of people does not depend exclusively on international capital. Through this process, many examples of successful financing mechanisms at sub-national levels have emerged, which both increase and maintain coverage for the poorest. Water services can be made affordable for the poor through a combination of taxation, charges, efficient collection methods and cross-subsidies.

Some of these will be discussed in this *Waterlines* issue. The article by Richard Franceys, 'Charging to enter the water shop', addresses the severe limitations connection fees pose to the urban and peri-urban poor, based on recent research supported by DFID in four countries. Complementing this piece, 'Financing household connections in Cote d'Ivoire' by Evariste Kouassi-Komlan and Théophile Gnagne, describes a programme developed by a domestic NGO, whereby the NGO pays for connection costs, and users repay the NGO over time.



This water tank outside the city serves a peri-urban area in Cape Verde