EUWI Finance Working Group

Briefing Note for 18th August 2004 Meeting

1.1 INTRODUCTION

This is a briefing note for the EUWI Finance Working Group (FWG) members to prepare for the discussion in Stockholm on 18th August 2004 of Agenda Item #3 by summarising the blockages and blockage busters identified in

- The findings of Phase 1 of the Finance Component of the EUWI and
- Those country experience reports provided by FWG members to date.

Countries included in this review (and the FWG members who provided supporting material) are:

- Ethiopia (Tearfund);
- Nigeria (WaterAid);
- Uganda (WaterAid);
- Madagascar (WaterAid);
- EECCA (OECD);
- Ghana (WaterAid, from their internet site); and
- India (WaterAid & WSP, from their internet sites).

Contributions were also provided by the Water Supply and Sanitation Programme (WSP) and the International Secretariat for Water (ISW), based on their experiences.

1.2 BLOCKAGES

Examples of blockages are presented under the following categories:

A. Who knows about existing financing mechanisms?

The number and complexity of existing mechanisms means that developing countries do not know what is available. This multiplicity also leads to confusion and conflicting conditionalities.

- Little is known in recipient countries about ***how to tap into the range of financing mechanisms*** on offer, aside from the traditional donor channels. It is often difficult for local agents to understand all of the different mechanisms on offer and to pursue any of them. As well as a lack of information, a lack of experience, capacity and resources are common constraints; and
- In Nigeria for example, EU funding mechanisms are found to be too bureaucratic and difficult to decipher (WaterAid), let alone the concepts and procedures behind any other finance mechanism on offer.

B. Who can obtain financing?

Financial mechanisms are often reserved for sovereign entities. Requirements on the financial standing or credit worthiness of recipient or the risk matrix of a project are often inappropriate for the water sector.

- ***Access to credit*** from finance institutions and capital markets is difficult due to perceptions of high risks in water and sanitation projects (WSP). Common risks encountered in the water sector include:

    - Input costs prone to increases over time (WaterAid – Nigeria);
    - Inefficiently designed and costly systems and projects (OCED – EECCA);
    - Inability to curb the leakages of water supply networks (WaterAid – Ghana); and
    - Corruption in meter readings (WaterAid – Ghana);

- The fragility of local capital markets also works against the sector. In Moldova, the ***domestic banking sector*** remains vulnerable; interest rates remain high; and banks offer only short-term loans. These conditions make obtaining finance for the sector difficult (OECD); and
- Project design approaches (commonly a ***lack of proper preparation*** or follow-up after completion) heighten the problems of obtaining finance (ISW).

C. Who benefits from financing?

Certain mechanisms do not allow the flexibility in technology used to meet the needs of the poor or apply conditionalities that are inconsistent with providing services to the poor. Financing should be funnelled through local entities to encourage local investment and financial markets.

- ***Mechanisms for ensuring accessibility*** to improvements by the poor are commonly weak (WaterAid); and
- Insufficient involvement and empowerment of ***local stakeholders*** in project design or implementation often occurs. (ISW).

D. When can financing be obtained?

The time frame for existing mechanisms and the conditions placed on obtaining such financing are often inconsistent with the needs of the water sector. There is a need to ensure that pro-poor projects can satisfy conditionalities.

- ***Major implementation delays*** of internationally financed projects often-mean collective demand remains wanting for several years (ISW);
- ***The sustainability of funding programs (especially donor initiatives) over several years is critical. This is often not the case;***

- Lack of capacity from ***community level through to local government*** and state level (Nigeria);
- ***Human resource constraints***: Junior staff are being attracted to opportunities with international organisations with more attractive salaries in Madagascar (WaterAid); insufficient number of trained personnel with adequate technical skills and competencies (Ethiopia, Ghana & Nigeria); and
- Poorly run ***support services*** to the WATSAN sector e.g. in Nigeria the unreliable electricity supply.

E. What kind of financing can be obtained/stimulated?

The mixture of grants, equity and loans available from or required by existing financial mechanisms is often inappropriate for the water sector. The currency of financing must match the revenues available to the water sector. There is also a need to improve leverage of domestic finance.

- User Finance is the best and most easily stimulated finance in the short term. However, matching funds are often limited;
- People are often ***willing to pay*** for improved services;
- At the State and Local levels in Nigeria, there appears to be a ***lack of willingness to contribute local counterpart funding*** for the water sector (WaterAid);
- ***Political interference*** in tariff setting in Nigeria (WaterAid); and
- Difficulty in ***regulating small scale water providers*** makes it hard to set tariffs in Ghana (WaterAid).

F. How much financing can/must be obtained?

The size of financing packages available is often either too large or too small to meet the needs of the water sector. Funding available for the water sector is too limited to meet the needs represented by the MDGs.

- Water spending is now 10% of the national budget and cannot be reasonably expected to increase further since there is ***competition for funds*** from other Departments. (WaterAid);
- In Nigeria the Ministry of Water Resources identified a ***large gap between available funds and investment needs*** to rehabilitate a decaying infrastructure and deficiencies in operations and maintenance (WaterAid);
- ***Absence of national sanitation policy***, and lack of state level decentralised programme for water supply (Nigeria & Ethiopia);
- ***Poor implementation*** of water strategy and sector development plan by the Ethiopian government (Tearfund);
- ***Opaque fiscal management*** e.g. 10% of Federal budget allocated to water, but not clear how much of this is allocated to WATSAN, as opposed to hydro and irrigation (Nigeria);
- ***Weak reporting mechanisms***, which may hold up the release of funds between governments and districts – this creates difficulties in making needed expenditure commitments (Uganda);

- ***Risk of corruption*** at the district level (Uganda) and concern relating to local government's ability to allocate funds appropriately to the water sector (Nigeria); and
- Too much ***red tape*** and ***restrictive tax systems*** (Ethiopia); and
- More can be obtained from users and well-targeted donor related finance instruments.

1.3 BLOCKAGE BUSTERS

Examples of blockage busters, practical ways to remove the blockages of funding identified above, are presented under the following categories:

A. WHO KNOWS ABOUT EXISTING FINANCING MECHANISMS?

It is acknowledged that harmonising donor financing is important and can help to alleviate confusion and conflicting conditions. This can be achieved by streamlining existing mechanisms by encouraging:

- A ***good policy framework*** for all donors to work within a single Programme for Development of Water Infrastructure will facilitate this process, at the local, national and regional levels (this is already in place in Madagascar at the national level); and
- A ***secretariat on water and sanitation*** in Ethiopia funded by USAID is being set-up to coordinate the work of NGOs and other stakeholders. This is seen as a positive indication that finances will be more effectively used as a result of this coordination (Tearfund).

B. WHO CAN OBTAIN FINANCING?

Improved access to and stimulation of local credit markets can be achieved through:

- Locally sourced financing can be promoted by supporting and enabling local credit markets;
- These kinds of initiatives can be developed by improving access to local credit markets, through technical assistance (grants) in preparing projects for financing, direct assistance to local authorities, or local government programmes focused on building credit-worthiness (WSP); and
- Micro-credit facilities can provide financing directly to individual households, for access to credit for construction of latrines for example (India).

C. WHO BENEFITS FROM FINANCING?

To help get finance to those who need it most:

- ***Decentralisation of resources*** is essential for the benefits of Watsan projects to meet the needs of the poor (ISW);

- Decentralisation of resources should go hand in hand with a ***decentralisation of the decision-making process***. This can be achieved by establishing and funding two regional platforms (Western Africa and Eastern Africa) in order to increase the number of local initiatives, delivered through decentralised funding mechanisms (ISW); and
- ***Community based organisation*** (CBO) funds, whereby kick-start funds are channelled directly to the communities rather than through local or national level.

D. WHEN CAN FINANCING BE OBTAINED?

Effective project preparation can be achieved through:

- ***Demonstrable willingness to pay*** (WTP) for improved Watsan services is important (India);
- ***Generating demand for services***, particularly for sanitation (India) helps create a sustainable sanitation services projects; this can be generated through ***effective social marketing*** of the proposed improvements in sanitation helps generate demand; and
- ***The private sector*** has an important role in providing consultancy expertise for project preparation (EECCA).

E. WHAT KIND OF FINANCING CAN BE OBTAINED/STIMULATED?

Donor funds should be used to help leverage other forms of financing.

i. Sustainable cost recovery through affordable and targeted user charges

- User charges are the only realistic long-term source of finance (OECD);
- People are willing to pay more for improved services (OECD)
- Consider applying user charges to recover recurrent costs, and use other sources of funding for capital costs (WSP – Africa); and
- Subsidies are often needed to make services affordable to low-income groups. Targeted subsidies, such as for new connections, are often better than cross-subsidy systems for usage fees.

ii. Use donor funds to help water sector improve collection rates

- Collection rates can be extremely low. If tariffs are affordable and sustainable there is a lot of subsequent value to be obtained from improving collection rates; and
- Improvements are possible even in poorer countries, without adverse social consequences, Nigeria collection rates have doubled (Nigeria).

iii. Enabling local communities to provide key services to reduce recurrent costs

- Enabling community resources for operation and maintenance of services to reduce recurrent costs; and
- This requires changing attitudes of both community and state suppliers (Uganda).

F. How much financing can/must be obtained?

- The creation of a ***reserve fund*** can smooth delays of the disbursement of funds between the financing institutions and projects at the grassroots level (ISW).