

The EUWI Finance Working Group – indicative proposals for 2009 – 2012

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The EUWI Finance Working Group is implementing a project co-financed by the ACP-EU Water Facility and DFID with a budget of €740,000 during 2008-2009. This project focuses on implementation of WSS sector financing strategies in two African countries and leaves little room for flexibility.

Proposals are made for new activities during 2009 – 2012 for which additional finance will be sought. Identification of such activities is proposed to be guided by five criteria: elimination of the distinction between IWRM and WSS, maintaining the EUWI character, resumption of the FWG as a genuine working group, continuation of the partnership with the OECD, and support to innovative activities.

On that basis it is proposed to give consideration to (i) supporting the country dialogues of the AWG, (ii) improved dialogue with AMCOW, (iii) workshops on finance for water practitioners, (iv) issues in water pricing, (v) extension of the FEASIBLE methodology to IWRM, (vi) enhancing the role of the private sector, and (vii) coordination and management of the FWG.

1. Present status

The Finance Working Group (FWG) is sustained by a project covering 2008 - 2009 (24 months) with a budget of €740,000 financed by a contribution of €400,000 from the ACP-EU Water Facility (WF) and the balance of €340,000 co-funded by DFID, there is also a modest contribution by Sida. The FWG is hosted by GWPO in Stockholm since July 2006 under an agreement between DFID and GWPO.

The project agreement signed between the EC and the GWPO for the WF contribution specifies in considerable detail the activities and costs foreseen during the project period and has little space for new initiatives. Over half of the budget (some 56 per cent) is earmarked for the preparation of financing strategies for the water supply and sanitation (WSS) sector in two African countries. There is also a component for capacity development and dissemination of the experiences from the two country projects (about six per cent of the budget).

These country projects are being implemented in partnership with the OECD applying principally the FEASIBLE methodology, although attempts will also be made in the two countries to apply the SWIFT methodology developed by the WSP with a view to comparing the different approaches. The objective is to define what may be considered to be best practice for financial planning for the WSS sector in an African context. There have been delays in implementation because of difficulties to reach agreement with partner countries.

2. Achievement of the FWG 2006 – 2008 work plan

During 2006 – 2008 the FWG was financed exclusively by DFID in the first two years, while 2008 is covered by the ongoing WF/DFID project. The work plan for this period includes four main activities:

1. Provision of financing expertise at country level in response to requests
2. Maximise opportunities for accessing EU resources available for support
3. Generate increased knowledge of finance mechanisms and policy tools for water-related development

4. Coordination and management of the FWG

Under activity # 1 WSS sector financing strategies have been completed in Ethiopia (October 2006), Mozambique (December 2007) and Moldova (December 2007). The strategy in Ethiopia was essentially an overview of finance in the sector, since the time available was insufficient to prepare a complete strategy to enable simulation using either FEASIBLE or SWIFT. The work done in Mozambique was carried out by consultants supervised by WSP applying SWIFT and covering the rural water supply sub-sector only. In Moldova consultants supervised by the OECD applied FEASIBLE. (In addition, the OECD has completed WSS financing strategies in Georgia and Armenia using FEASIBLE working under the auspices of the EUWI EECCA Working Group, and it is applying FEASIBLE in Egypt under the EUWI MED Working Group.)

Activity # 2 generated different technical comments on the functioning and the extension of the ACP-EU Water Facility. Under activity # 3 a series of workshops was carried out in 2007/2008 to bring together water practitioners and finance experts to raise awareness about financial tools and opportunities (see separate note).

Activity # 4 has continued throughout the period. During 2007 and 2008 much effort was devoted to launching the two country strategy projects, dialogue was initiated with two countries but after 6-8 months turned out to be inconclusive. By July 2008 preparations were well under way for start of a project in one country (Lesotho) and dialogue had been initiated with another (Mauretania).

Reference is made to the EUWI 2007/2008 annual report for further details.

3. The 2009 work plan

Under the ongoing FWG project the 2006-2008 work plan and its four activities has been extended to cover also 2009, no additional activities have been added. The focus will be on implementation of the two country financing strategies, both should be completed during the second half of 2009.

The project budget provides for two workshops, one to be conducted in English and the other in French, to be carried out during the second half of 2009 to disseminate experiences from the two country projects. Compilation of material for these workshops will perforce start well before the projects are complete but should still be able to capture much of what has been learned and relate these experiences to those gained from the completed projects in the EECCA region as well as other country financing strategies carried out in Africa by WSP.

A concept note has been prepared with proposals for a resumption of the workshops on water finance in collaboration between GWPO/FWG and IRC/AWG. This will be an activity additional to the FWG project supported by WF and DFID. If finance can be found it is planned to start the first of a series of five regional workshops around mid-2009, planning for them would absorb much of the first half of next year.

4. New activities in 2009 – 2012 – assessment and criteria

As said, the FWG project during 2008-2009 has a strong focus on the two country WSS sector financing strategies. It is not proposed that the FWG would carry out any more country strategies of that nature. If the FEASIBLE approach is found to be feasible, interested partner countries should with little difficulty be able to prevail on donors to support them on a bilateral basis. The contribution of the FWG to demonstrate a viable methodology should then be considered complete.

In the medium term, defined as 2009 – 2012, the FWG may engage in new activities identified on the basis of the following five considerations:

1. *The distinction between water resources management (IWRM) and water services (WSS) should cease.* The EUWI has been launched to help partner countries achieve the MDG targets defined in terms of water and sanitation service provision. Still, when discussing issues relating to finance in practical terms, it is clear that the distinction between water resources management and WSS service provision often has little meaning. These issues arise out of a felt need to manage scarce water resources better for purposes of improved provision of basic services, and it makes more sense to focus on the commonalities of the water sector writ large.
2. *The EUWI character should be retained.* The FWG derives from the EUWI, in fact was one of the first EUWI working groups to become operational, and this should not change. This means that future activities should seek to engage EU Member States in collaboration and contribute to achievement of the overall EUWI objectives.
3. *FWG should resume being a working group.* As said, the ongoing FWG project leaves little room for flexibility. In practice, this means that FWG functions more like a project with a fixed work plan rather than a working group with ability to accommodate views on new activities expressed by partners and stakeholders. The ambition should be that the FWG after 2009 should revert to being a forum for debate on water finance with resources to adapt to emerging priorities. However, this assumes financing arrangements different from those now in force.
4. *Continue the partnership with the OECD.* The collaboration between the OECD and the FWG derives from a joint environment-development ministerial meeting in April 2006 that identified “sustainable financing to ensure affordable access to water supply and sanitation” as a priority theme of work for the OECD Environment Directorate, while addressing one of the OECD Secretary-General’s priorities. A so-called member-led task team has held consultations on this theme during 2006 - 2008, and the FWG is represented on this task team. This work theme will be concluded with a report to the World Water Forum (WWF) in Istanbul in March 2009. Assuming that the OECD will be mandated to continue its work on water finance after the WWF, the current partnership should continue. It gives benefits to both sides, since the analytical capability of the OECD is complemented by the outreach provided by the FWG.
5. *Support innovative or experimental activities.* The FWG should never be seen just as another donor, supporting activities that the donor community could do anyway. Its value added should be to function as a (figurative) workshop for innovation and experimentation, trying out new approaches that may later, if found viable, be more widely disseminated by the donor community, partner countries and other stakeholders.

5. Possible new activities in 2010 – 2012

Using these five criteria a list of possible new activities for the FWG in 2010 – 2012 is outlined below and summarized in the attached table. Some of them may commence already in 2009, depending on the availability of finance. Most will require considerable preparatory work to be carried out by external consultants before they can be supported. Generally, no attempt has yet been made to estimate costs.

1. *Support the country dialogues of the AWG.* In its ongoing work plan the AWG has provided for country dialogues in five African countries during 2009-2010 “in response to specific requests from national governments”. These country dialogues are expected to be based on a “strategic approach to sector financing” and be carried out in collaboration with the FWG.

There are several issues relating to the EUWI country dialogues carried out to date. Since the EUWI is not a financing instrument, dialogues on WSS sector policy with partner countries was seen as a logical first step to identify impediments to progress toward the MDG targets. However, some EU MS

did not identify with the dialogues, their country missions saw them as an imposition from the outside and refused to cooperate, in some partner countries they were initiated but lacked focus, and they fell in disrepute. An ongoing study by SIWI will assess the issues involved and propose a modified approach, its findings are expected later in the year.

Without prejudice to the SIWI study it would appear likely that any continuation of the EUWI country dialogues would have to depart from an assessment of the WSS sector finance as related to stated objectives and targets. It will evidently not be possible to embark on a full-fledged financing strategy at the outset, but an outcome of the dialogue may be a decision to work toward completion of such a strategy. By focusing the dialogue on a strategic approach to sector financing it should be possible to better capture the interest of partner countries.

That said, it will be necessary also to convince the EU MS and their field missions. The EU MS aid agencies have delegated decision-making authority for bilateral programmes to their field missions, and unless the missions are in agreement the country dialogues will not make progress. How the field missions can be convinced to buy into a modified approach to the EUWI country dialogues is for the AWG to ponder. If such a modified approach can be widely agreed and adopted, the experiences gained by the FWG from the financing strategies will be valuable.

2. Improve dialogue with AMCOW. One of the disappointments of the EUWI African component is the unsatisfactory dialogue between EU and AMCOW. Despite considerable support from the WF channelled through UNEP in order to strengthen the AMCOW secretariat, working contacts with the AWG remain limited. Although there are many examples of constructive personal relations between AMCOW and EU representatives resulting from meetings under EUWI auspices, there is little ongoing collaboration.

That will need to change, if a new approach to the EUWI country dialogues is to be adopted, indeed if the AWG is to make meaningful progress. The FWG should contribute by offering to provide AMCOW with a comprehensive assessment of its experiences from the country financing strategies and proposals for further work in related areas (see further below). The format for this exercise would obviously have to be agreed with AMCOW, but it could take the form of a seminar for members of the AMCOW Technical Advisory Committee (AMCOW TAC) to be conducted in late 2009 or early 2010 in conjunction with one of the regular meetings of this body.

3. Workshops on finance for water practitioners. This is covered by a separate concept note, proposing the continuation of the completed series of three regional workshops by another series of five commencing in mid-2009 and continuing through 2011. Each regional workshop would be supplemented by two country roundtables going more into detail at nation or basin level. The idea is to raise awareness of water professionals of the tools and sources of finance for the water sector. A preliminary cost estimate for this activity is €600,000.

4. Issues in water pricing. Strategies of governments for providing improved WSS services tend to be supply-driven, and the fundamental importance of demand in the selection of appropriate policies has often been ignored. Effective policy and planning must therefore take into account what customers want and are willing and able to pay for. Empirical studies suggest that the willingness to pay for improved WSS services does not depend solely on income but equally on the characteristics of both existing and improved supplies. Often household income, although important, is not the overriding determinant of demand for improved services.

Policies for the supply and pricing of water need to take into account the characteristics of demand, including the households' willingness to pay for improved services relative to the full costs of supply. There will be situations where these costs will be high due to aridity, low population densities, or lack of other infrastructure (for example, electricity), and where improved systems cannot be built and

operated without subsidies, but even in these cases any improvements must be demand-driven and resources mobilized from beneficiaries. There will also be situations where the natural resource endowments and local poverty combine to preclude financially viable options for improving WSS services, where subsidies may be better used for other community services than WSS.

For local authorities and water utilities it will be important to make these choices explicit and build them into price structures for WSS services with a view to defining viable full-cost pricing strategies. Often there is a need to define explicitly the cases where subsidies to consumers may be justified and where they may not be. The OECD has an ongoing study of water pricing, the findings of which will be presented to the WWF in March 2009. The FWG would translate these findings into a programme of capacity development for local authorities and water utilities to be implemented during 2010 – 2011.

5. Extension of FEASIBLE methodology to IWRM. The FEASIBLE methodology has been developed for the WSS sector as a decision-making tool that makes explicit the policy choices and accompanying trade-offs in designing policies and programmes for provision of improved basic services. It seeks to engage all major stakeholders involved in financing WSS services in policy dialogue and consensus-building to make it easier to implement programmes effectively, improve service quality and achieve WSS targets.

Many of the characteristics of the FEASIBLE methodology would apply also to water resources management under the IWRM umbrella: policy dialogue and consensus-building are key characteristics also of IWRM. Many partner countries have developed IWRM national plans, as prescribed by the World Summit on Sustainable Development in 2002. However, these plans typically remain unfinanced and play a limited operational role, usually because they have never been subjected to financial analysis, indeed to financial realism, and therefore tend to remain mostly on the shelf.

Specifically, it will be necessary to link the IWRM national plan to the medium term expenditure framework (MTEF), providing it with the different analytical techniques and monitoring indicators that would permit for the ministry of finance to monitor its implementation with regard to key policy objectives, for example poverty, environment, and gender equity. This will require a number of pilot projects in partner countries and the financial resources to sustain them.

Pilot applications of FEASIBLE to water resources management would be carried out by the OECD in collaboration with the FWG during 2009-2010. The findings from this methodology would be documented and disseminated to partners during 2011-2012 by the FWG working in partnership with the GWP and the OECD.

6. Enhancing the role of the private sector. At present some 90 per cent of all water is being delivered by publicly owned institutions. Still, it has long been evident in many countries that to achieve political objectives for quantity and quality of WSS services it will be necessary to expand private sector delivery. In developing countries public utilities cater mostly to the demand of the urban areas, leaving supply in rural areas to a patchwork of projects and programmes sustained by the government, often supported by external donors, by NGOs, and by local communities.

The experiences of the private sector in the supply of WSS services have been decidedly mixed, as many of the large European water companies have failed to make investments in developing countries pay off. Local politicians will not allow water tariffs to be raised to the levels necessary for the companies to cover their costs, and there have been shortcomings in the local institutional framework and governance, particularly with regard to effective regulation. As a result, private participation in WSS projects in developing countries has declined in the recent years.

There are financial instruments that can be used to enhance private participation in WSS service delivery that are not being widely used because key professionals in the water sector are not familiar with them. These instruments were covered, albeit superficially, in the workshops mentioned in section 3 above. Some of them may warrant more development to make them practically useful in specific countries. These instruments include (i) bonds, or fixed interest securities, that offer the purchaser the promise of repayment at a specified future date and in the meantime paying a fixed rate of interest, (ii) equity finance in which suppliers (investors) share the risks of the project in return for the prospect of sharing its profits too, (iii) guarantees and risk sharing, where lenders and equity investors can guard against political, contractual, regulatory, foreign exchange and credit risks.

The FWG would explore the application of these and other instruments to enhance private sector involvement in the supply of improved WSS services. Priority would be given to countries where water policy dialogues or financing strategies has evidenced a potential for a wider role by the private sector. This activity would therefore derive from prior work on the dialogues and be carried out during 2011 and 2012.

7. Coordination and management of the FWG. Current arrangements with the FWG hosted by the GWPO will remain in place until the end of 2009 when the FWG project comes to a close. Before that time a review should be undertaken to ascertain whether any change of these arrangements would be called for.

As part of the transition to a follow up of the ongoing project the FWG would create an advisory group of 5-10 senior experts to assist in the design of what would in essence be the fourth phase of the FWG. NGO stakeholders should be represented on this group which should be operational early in 2009.

6. Next steps

The proposals in this note would be revised after receipt of comments from participants in the FWG meeting in August 2008 and in consultation with the aforementioned advisory group. Contacts would then be taken with possible donors, and a consultant would be engaged to prepare project documents that could be used as a basis for funding agreements. The objective is to have such agreements in place by mid-2009.

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Indicative FWG work plan 2009 - 2012

Activity	Objective	2009	2010	2011	2012
AWG country dialogues – FWG support to five of them	Assist AWG in focusing the dialogues on strategic financial approaches	-----	-----	-----	
Collaboration with AMCOW – carry out seminar on WSS sector financing strategies	Experiences from the strategies disseminated to members of AMCOW TAC	-----	-----		
Training in finance for water practitioners – five regional workshops and ten country roundtables	Raised awareness of water professionals of financial tools and sources	-----	-----	-----	
Issues in water pricing – translate findings from OECD study into a capacity development programme	1. Completion of package of study materials 2. Implement capacity development activities	-----	----- -----	-----	-----
Extension of FEASIBLE methodology to IWRM – pilot projects, documentation and dissemination of findings	1. Pilot projects in four countries 2. Documentation and dissemination of findings		-----	----- -----	-----
Enhancing the role of the private sector	1. Review of suitable financial instruments in selected countries 2. Wider application of selected instruments in these countries			-----	----- -----
Coordination and management of the FWG	Efficient FWG management	-----	-----	-----	-----