

# The Global Financial and Economic Crisis and the Water Sector

## Summary of policy report for Sida, November 2009

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This report analyses the financial situation in the water sector of developing countries in the light of the international financial and economic crises. Its key messages are as follows:

1. **Financial crisis and food crisis have set back growth and poverty gains.** The global financial crisis that has developed since 2007 has overlapped with the earlier food crisis, and has, together with fluctuating energy costs, compounded the economic problems of many developing countries, including many of the poorest. Economic growth in Africa as a whole is likely to decelerate from an estimated 5.7% in 2008 to 2.8% in 2009, affecting most severely those with lesser economic diversification and greatest dependence on external finance.
2. **Persistent underinvestment in water.** These twin crises are overlaid on a more fundamental crisis for water in many countries that has been made even worse by recent events. The basic problem is underinvestment in three key aspects of water, namely: 1) water services, both for basic needs and productive services necessary for economic growth, 2) water resource management and development and 3) governance functions (such as sector management, regulation, pollution control, data collection and monitoring).
3. **Deteriorating and deficient infrastructure has stalled MDG progress.** The cumulative result of neglect and underinvestment is deterioration in the infrastructure providing water services to households and farmers, and a lack of infrastructure to cope with the succession of droughts and flooding worsened by climate change. Many countries, especially in Africa, are seriously lagging in their progress towards achieving the Millennium Development Goals for water supply and sanitation, and other MDGs (notably poverty reduction, hunger reduction and access to energy) where water infrastructure has yet to make a key contribution.
4. **Financial vulnerability of water services.** Water services are particularly vulnerable in the current financial climate. The three basic sources of revenue – tariffs, taxes and external transfers (the “3Ts”) – are all likely to suffer. This is affecting access to repayable sources of funds to the sector such as commercial loans, bonds and private equity.
5. **Seven impacts of the crisis.** Developing countries have been affected by the economic crisis through seven principal impacts: financial, trade, commodity prices, foreign direct investment, remittances, aid disbursements, and exchange rate movements. The net result of these impacts varies by countries, and some countries will even gain, but most African countries will end as losers. The situation is still evolving, and the permanent impacts are unlikely to be known for some time.
6. **Long-term problems aggravated by the economic crisis.** The water sector’s difficulties will be aggravated by the crisis. Evidence based on previous financial crises, most recently that in East Asia in 1997, indicates that investment in infrastructure will be reduced, with long term repercussions on growth and poverty reduction.
7. **Deficient financial flows in Africa.** New estimates indicate that Africa’s annual financing requirements for water could be US\$ 50bn, in drinking water and sanitation, wastewater, desalination, irrigation, water management, hydropower and multipurpose storage. Compared with this need, current flows are deficient in many respects: overall amounts are inadequate, geographically imbalanced, and insufficient to fund capital expansion and recurrent costs (of operation, maintenance, governance, resource management and observational networks) at the rates needed for growth and development.

## What could Sida do?

Sida could respond to these threats in two ways – firstly, reacting to the urgent challenges posed by the current global financial and economic crises, and secondly, grasping a number of Levers of Change in order to raise the long term rate of investment and funding for the global water sector. For both types of action, Sida would need to take a number of enabling measures to position itself as a leader in global water concerns.

### Response to international financial crisis, based on the following considerations

- supporting macro-economic stimulus especially targeting affected groups,
- injecting decentralised finance to those deprived of central government allocations
- sharing the extra risks perceived in financing water, to promote the right kinds of commercial funding (loans, bonds and equity).
- using existing platforms for blending grant with loan finance to compensate for the shortage of commercial funds, and to link with the new lending efforts from IFIs.
- improving cash flow and general financial status of water undertakings to make them more efficient and credit-worthy for attracting needed finance (from all sources).

### Levers of change to overcome long-term underfinancing of water by addressing;

- The crucial role of regional organisations especially in Africa
- A shortage of projects that are adequately prepared for funding purposes
- The growing importance of IFIs for funding water infrastructure in the wake of the current crisis and possibilities of co-financing with multilateral sources.
- The benefits of using grant finance in “smart” ways to alleviate risks, in order to stimulate a multiplied volume of commercial (including private) finance
- The value of governments taking a longer term and strategic approach to the planning and finance of water, through Strategic Financial Planning.
- Recognition that much of the hard core of global water problems exists in “fragile” states, which pose the challenge of moving from short term aid for humanitarian purposes towards long term development assistance.
- Leadership in neglected areas, including agricultural water use, hydropower and policy links to climate change, through innovation and applied research

## Enabling actions for Sida

To undertake measures such as those proposed, Sida can consider raising the targets for ODA spending in the water sector by reorienting and restating its aid policies, and making the necessary strengthening and changes to its internal structures and practices.

Sida starts from the fact that Swedish development assistance to water was officially at 3.3% of Sida’s total ODA disbursements in 2008, compared to an OECD average of 8% in 2006.

Moving forward, the following enabling actions could be considered:

- a) Identifying crisis response options urgently through rapid assessments
- b) A comprehensive update of Sida’s water policy and financial commitments
- c) Strengthening and supporting Sida’s internal services and country teams
- d) Forging global partnerships with IFIs, DFIs and bilateral ODA alliances
- e) Maximizing input by Sweden’s human resource base to support implementation
- f) Leading the global water agenda for real development outcomes