Summary

The Task Force on Financing Water for All was established to provide recommendations on innovative financing mechanisms and make concrete proposals for immediate action that enhance the access of local governments to financial resources for investments in water services and agricultural water management. The Task Force has an open mandate and will continue after the 4th World Water Forum.

The tasks cover an assessment of (i) the status and trends in water financing, (ii) reasons behind current water financing trends, (iii) examples of innovative financing options being explored and tested with local governments and (iv) the future of financing for the water sector, particularly at the local government level.

The Task Force has given special attention to (i) the financing needs of local governments, especially as they are increasingly being faced with impacts that accompany decentralization, and (ii) the financing of necessary investments in agricultural water management to enhance efficiency and productivity of the sector that uses the most water.

The Task Force, however, is mindful of the equally important work of financing improvements in the management of river basins. River basins are the foundation of the water sector and a key component to ensuring that water services are sustainable. Innovative financing at increased levels will be needed for resource management, which will still depend largely on ODA and the public sector, but efforts need to be made to make this more attractive for the capital market. The Task Force will study and advocate further work in this area.

Access to Finance for Local Governments

Recognition of the demand side – a shift of focus on financing issues

In 2003, the Camdessus Panel warned that the Millennium Development Goals (MDGs) would not be achieved unless annual investments in water supply and sanitation services in developing countries are doubled from the 2003 level (US$15 billion per year to US$30 billion per year). These figures were confirmed by TF7 of the Millennium Project and by Water Aid. The water sector is, however, experiencing decreased, static, or marginal increases in financing, despite recommendations to double investments. The Camdessus Panel's call to double the level of water finance has not, and will not, expire. This higher level is still required and must be achieved.

The fact, however, that financing has not increased points to a more fundamental problem in the financing paradigm. The Task Force finds that the prevailing paradigm, evidenced in the Camdessus Panel Report, has focused too narrowly on how to create a greater supply of water financing without addressing the demand for it. The Task Force calls for a sharper focus on under-considered, yet fundamental, issues from the demand-side that are affecting financing levels: tariff structures, regulation, local capacity and access to various finance options for local governments and service providers.

It is necessary that National Governments develop policies to address these issues, while recognising that water is a local affair and that its sustainable management requires the empowerment of local governments and the development of their fiscal, management and human resource capacity. Given the contextual nature of water issues there is no silver bullet or one-size-fits-all solution.

Sustainable management requires the empowerment of local governments and the development of their fiscal, management and human capacity.

Provision of water services is primarily a local affair

Water is a local affair because water services [1] are provided by local entities on a local scale to citizens of villages, towns and cities. The local government has the responsibility to provide their citizens with adequate services. They need the fiscal, human and institutional capacity to manage existing water services in a sustainable way and to extend services to the un-served. It is local action that enables the mobilisation of local social and financial capital and that can call upon solidarity mechanisms in society: an essential element for development of their financial capacity. On top of that, decentralisation increases responsibility at the local level.

Customers and taxpayers mainly finance water services

Financing new investments is only possible if repayment of the finance necessary for these investments is assured. In provision of rural and urban water services revenues come almost 100% from the contributions of users and the public budget. It is this repayment capacity that determine the financial health of the service providers and their access to finance for new investments. The focus on enhancing access to finance issues should, therefore, be on this capacity of local governments and local operators to provide services and recover the associated costs both in urban and rural areas. A transparent and accountable relationship with the customers is a prerequisite for for sustainable cost recovery.

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Fair tariffs combined with targeted subsidies are needed to connect the un-served, especially the poor

In poor areas, as elsewhere, the cost of service provision needs to be balanced by the potential for revenues (user fees and taxpayer contributions). Acceptable, fair and pro-poor tariff structures are important to sustain the existing services and to obtain additional financing to extend services to the unserved, especially the poor. Solidarity among customers, cities, and countries through cross-subsidies and targeted subsidies is necessary to provide the poorest and the unserved with affordable access to basic services. Technology selection and service levels need to be adjusted to this potential and agreed upon among customers, service providers and local governments in association with tariff and subsidy structures.

Building local capacity is necessary to develop financial flows

Lack of local capacity is one of the main obstacles in financial flows. Capable and accountable institutions, well-informed citizens and clear development strategies are essential elements to move forward. To access financing the capacity to structure projects and to manage investments in a sustainable way is crucial. Central governments should empower, facilitate and strengthen the capacity of local stakeholders in development, structuring, implementing, and managing local projects and services to enable effective local financing. This requires effective decentralisation, the devolution of not only responsibilities but also of the associated budgets and removal of obstacles in flows of funding from the central to local governments.

Financed through grants, development of service strategies, project preparation and structuring capacity will remove a major obstacle in financial flows. The set up of a "project preparation fund" or "debt for project preparations" swaps could facilitate this process.

Careful management of the relationship between local and national government is needed because of existing interests and possible differences in political signature

1- Water services in this report are to be understood as services directly provided to individuals or groups of society like water supply, sanitation, sewage, waste water treatment, drainage, etc. Infrastructure for bulk water supply in river basins or even inter-basin transfers can also be the affair of a basin organisations, national governments or even international bodies.

on the two levels. The pace of this implementation needs to be carefully phased, as competencies and capacities differ from place to place. Dialogues between central and local governments need in many instances, to be initiated, facilitated and strengthened.

All governments must examine and take steps to increase the flow of budgeted allocations for water, focussing in particular on blockages in the flow of funds to local entities responsible for extending water services. More responsibility and financing should be devolved to local government authorities and municipalities to enable local financing, improved service delivery and direct links with customers and access to local capital markets.

Projects should be structured through dedicated partnerships, matching demand and supply

Involvement of all stakeholders is necessary for development and establishment of sustainable and affordable services. Establishing dedicated partnerships in which all parties cooperate (local and national government, users, public and private operators, local and international financiers) is essential for matching better demand with supply of services and their financing. These partnerships will create feasible financing and repayment mechanisms and exploit local financing options that are often overlooked. Since the broad range of stakeholders will demand transparent and accountable management processes, the risk and the cost of financing can be reduced. This will enhance service delivery, the willingness of users to pay and the creditworthiness of local governments. Such partnerships will enable a higher quality preparation, structuring and implementation process of investment projects. Bilaterals and IFIs should include the establishment and strengthening of such partnerships as part of their assistance to countries in the process of project preparation.

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Enhancing financing flows requires development of local capital markets and their accessibility for local governments

National governments should develop and improve local capital markets to make local currency loans possible and more attractive. Ministries of finance or treasuries should provide local governments and service providers with (better) access to local capital markets instead of forcing them to borrow in foreign exchange, increasing currency risk.

National development banks or other intermediary bodies can be important in the development of a local capital market to subsidise loans and to facilitate access to credit for financially weak local authorities. They have to be strictly monitored to benefit all local governments. In the long run, when local financial markets are strengthening, they should slow down their actions not to undercut the growth of commercial banks and stifle the emergence of a healthy local capital market.

Bilateral and multilateral financing agencies should coordinate aid to stimulate development of local capital markets making local currency loans possible and more attractive. Leveraging capital in these countries allows donors to provide more resources to those countries where financial markets are weak or non-existent to invest in their water infrastructure. Concertation of efforts of IFIs and bilateral donors in this direction will enhance the effective use of the limited resources available.

More money is needed and better use should be made of the money available

Despite the progress in the development of financing instruments and their applications, doubling all flows of money (ODA, private sector, water-users and taxpayers) required to meet the MDGs is still far from being achieved.

ODA responded positively to the Camdessus Panel Report recommendations and developed innovative financing instruments to help put local governments within reach of special financing mechanisms that they are otherwise unqualified for. These innovative financing options, some of which are already being implemented, include sub-sovereign financing, bonds, guarantees and other instruments.

Though ODA is only a small part of the total amount of resources required to invest and manage water services, it can be significant in leveraging other funds and developing confidence to create access to (local) capital markets. Establishment of revolving funds and provision of (partial) guarantees for loans and bond issues can enhance creditworthiness and develop confidence in local currency markets. ODA also plays a crucial role in providing the upfront capital needed for investment in infrastructure and in providing guarantees for output-based aid (OBA). Without this critical input, in some places the contributions from consumers and taxpayers could not take place because there would be no service for which to pay.

The Task Force recommends that ODA contributions should also explore new sources of financing, which—currently being tested—include (i) external guarantees for local currency finance, (ii) grant aid as leverage, (iii) pooled bonds issued by groups of municipalities, (iv) local savings (pension funds, insurance companies and individual investors) drawn into financing bonds, (v) multilateral financiers now able to offer local-currency loans using the proceeds of bonds raised in local capital markets, and (vi) credit rating agencies extending services to subsovereign bodies to improve financial discipline and credit worthiness.

Further development and upscaling of special water facilities is encouraged like the African Water Facility (AWF) and European Union Water Facility for African Carribbean and Pacific Countries (ACP-EUWF) because they give local actors direct access to international funding.

Development of solidarity and decentralised funds based on the involvement of citizens at local, national and international level is encouraged to provide support for service development especially in rural and marginalized areas. These funds do not form part of the ODA budgeting systems. For instance, twinning arrangements between cities, towns, utilities and operators are making more and more progress. Though still relatively small, these arrangements create awareness and can stimulate action on a local scale.

The government with the initial support of international and national financing institutions should develop more effective and diverse credit systems for investments in community of small scale water services made by others, whether communities, the local private sector or other organisations. This can take many forms, including through existing banking systems, direct credits to NGOs or other organisations and credit systems (Asia Water Watch, 2005).

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Special attention is needed for countries where infrastructure is weak and capital markets are lacking

Poor countries with a low development level of infrastructure and where capital markets are absent face special challenges. The costs for infrastructure development are the highest and access to needed finance is lowest. These countries need long-term soft money to build institutions and infrastructure at the national and local levels. These countries that are in greatest need only receive a small part of ODA. International solidarity between the wealthiest and the poorest countries is necessary to create investments that otherwise cannot be afforded through national taxation.

Phasing of self-reliance in service provision is important. There is a gap between demand side and the capability of the economy to carry the burden of the costs associated with water infrastructure. In the short and medium term, grant-based ODA and solidarity mechanisms are crucial as a first step in bridging this gap.

National and local action plans are needed to increase the levels of investment

National Governments, especially those with PRSPs, will give in their planning water the proper priority for financing.

The Task Force recommends that national and local governments should develop action plans to facilitate an increase of the levels of investments in water at municipal and district levels. Needs are to be identified and quantitative and qualitative targets need to be set on water services and associated financial expenditure and cost recovery (fees and subsidies) through national-local dialogue. The action plans should distinguish clearly between urban and rural water supply and outline a package of interrelated measures incorporating:

- Policy reforms and improved regulation for sustainable service provision on cost recovery and efficient pro-poor tariff structures; public and private sector participation modalities.
- Development of project structures based on partnership approaches.
- Phased investments – commencing with improvements in efficiency and reliability of service provision.
- Financing instruments and arrangements including development of and access to local capital markets for local governments and water service providers.

An umbrella action plan needs to be adopted at a national level. The Task Force believes that without such plans and their determined implementation the efficient management of the world's most crucial natural resource, and its benefits for the poor will remain mere rhetoric.

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Financing Water for Agriculture

The future state of water management for agriculture will be determined by a growing scarcity of water, competition for its use and growing concerns about its environmental impact. For these reasons and from the disappointing performance ODA to the sector has dropped sharply. However, agriculture is the greatest user of water and much investment is needed to make the sector more water productive. The next generation of investments will therefore be different from the last in type, scale, sponsors, and modes of finance.

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The Task Force recognised the complexity of the issues around financing water for agriculture and the need for further study, consultation and analysis. At this interim stage the findings of the working group resulted in the formulation of three main questions around this issue to be developed in the next stage of the work of the Task Force:

- What are the needs where for financing water management infrastructure for agriculture? Should it be on efficiency improvement, expansion of irrigated agriculture, technology development? And whose needs are they as they vary from small-scale subsistence agriculture to large-scale international commercial enterprises?
- Who should pay for these investments? Within the distorted agricultural market the separation between public and private interests has become very vague. Where does the public responsibility end and where does the private responsibility start?
- What mechanisms are most appropriate? The wide variety of functions of water in agriculture and the large spectrum of size of operations which all need to be properly funded, demands for a mix of instruments that need to be consistent and complementary.

All kinds of finance will be conditional on supportive policies, reformed institutions, sound projects and creditworthy borrowers. In order to attract the required amount and types of funds the sector as a whole will need drastic reform.

Water institutions will need to make a strong effort for capacity development, including participation, empowerment, technical assistance and organisational development. The re-education and training of staff is an important part of this. Staff exchanges, benchmarking, "south-south" cooperation, twinning, and other kinds of technical assistance all have a potential role to play.

The trend to give Water User Associations more delegated responsibilities needs to be accompanied by sufficient delegation of powers ("voice and choice") to enable them to function effectively in this new environment.

Future spending by national governments should be more functional in order to support necessary reforms. Departments should examine the reasons for any underspending that occurs and take action to remove administrative blockages.

External aid will continue to be needed in this sector, though on a more selective basis than in the past. Donors should be more receptive to new roles for aid, with the keynotes being facilitation, leverage and capacity building.

In order to secure finance for essential major infrastructure from IFIs and commercial lenders, working arrangements are required, which take account of the key elements of the World Commission on Dams report. However, these should avoid unnecessary delays and complex procedures, which deter both society, financiers and borrowers. There should be a specific study of the experience of dams and other major hydraulic projects concluded since 2000 with IFI involvement.

Water charges to users are a grossly under-tapped source of finance with great potential, and the only sustainable source of finance for recurrent operations. However, service agencies will need to be more customer-oriented and provide a better service if this potential is to be realised. Greater attention also needs to be paid to improving access to local and foreign markets for agricultural produce. Further study is desirable of cases where irrigation tariff reform has been successfully introduced.

The key to involving a wider range of financial sources is to identify the specific risks of this sector to investors and lenders, and to address these risks through financing structures. Co-financing from various sources is feasible, with each funder assuming appropriate parts of the risk. Further study is recommended of recent cases of PSP in this sub-sector.

Governments, donors, and IFIs, with the support of international networks and other stakeholders, should develop appropriate fora (e.g.Round Tables) involving local financial service providers to identify ways of promoting microfinance in water for agriculture. Governments should also review the impact of existing credit and capital market controls on the potential development of a microfinance market for this purpose.