

Financing and aid instruments for water and sanitation

1. Background

1.1 The UN Millennium Development Goal on environmental sustainability includes two targets for the water supply and sanitation sector, to halve by 2015 the proportions of people without access to safe water and sanitation. Meeting these targets requires 300 thousand new connections to water and 450,000 new connections to sanitation services every day until 2015¹. Current investment will need to double in order to meet the targets, from some \$15bn pa to \$30bn².

1.2 The message is clear. Governments, donors and consumers need to commit more resources to water and sanitation. The current failure to invest brings with it a terrible human cost but also an economic burden for developing countries. Water related sickness drains already stretched health services and undermines other development spending – for example on education. WHO estimates that 5.6 billion working days and 443 million school days would be gained annually if there was universal access to water and sanitation. In total, the status quo is costing developing countries \$84 billion a year³.

1.3 Governments of developing countries are not giving priority to water and sanitation in national budgets. WaterAid research⁴ shows that where scarce resources do reach the sector, they are often poorly targeted and ineffective. The very poorest people are often excluded from project benefits; investment priorities may be skewed against poor areas and against low-cost appropriate technologies; schemes may prove unsustainable in either financial or managerial respects. Tackling these issues is complicated by the failure of many donors to support and participate in sector wide coordination. Greater coordination and transparency regarding investments is key to improving the performance of the sector and ensuring equity of access to services.

2. Prioritisation of water and sanitation

2.1 DFID policy documents recognize that investment in water and sanitation can enhance the prospects of achieving the other MDG targets, especially those related to primary healthcare and education. And yet, water and sanitation continue to receive a small share of DFID's allocable aid.

2.2 DFID has reported that overall expenditure (bilateral and multilateral combined) in the water sector between 2004/05 was £200 million⁵. This represents just 5% of the total expenditure that year. The White Paper on Governance announced plans to double annual bilateral spending in Africa to £95 million by 2007/08 and to £200 million by 2010/11. The pledged increase is welcome but the overall spend will be relatively modest when compared to the one billion pound annual spend pledged for education.

1 WHO/UNICEF, Joint Monitoring Programme for Water Supply and Sanitation, Meeting the MDG drinking water and sanitation target : the urban and rural challenge of the decade (2006) http://www.wssinfo.org/en/40_mdg2006.html

2 For a discussion of the base calculations used for these estimates, see World Water Council, Costing MDG Target 10 on Water Supply and Sanitation: comparative analysis, obstacles and recommendations (2006) <http://www.financingwaterforall.org/index.php?id=1099>

3 WHO, Evaluation of the Costs and Benefits of Water and Sanitation Improvements at the Global Level,(2004) http://www.who.int/water_sanitation_health/wsh0404/en/

4 WaterAid, Getting to Boiling Point (2005)

http://www.wateraid.org.uk/documents/getting_to_boiling_point_1.pdf#search=%22getting%20to%20boiling%20point%22

5 Department for International Development, Update on Water Action Plan (2006)

[http://www.DFID.gov.uk/pubs/files/update-water-](http://www.DFID.gov.uk/pubs/files/update-water-sanitation.pdf#search=%22DFID%20water%20action%20plan%20update%22)

[sanitation.pdf#search=%22DFID%20water%20action%20plan%20update%22](http://www.DFID.gov.uk/pubs/files/update-water-sanitation.pdf#search=%22DFID%20water%20action%20plan%20update%22)

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2.3 There is a pressing need to update policy frameworks and link these closely to practice in country programmes. The 2005-2008 Public Service Agreement (PSA), which underpins the departmental strategy and defines performance objectives, does not include a sub-target for WSS. Including a performance target for water supply and sanitation in the next PSA would clarify the focus of DFID's strategy for the sector.

2.4 The objectives of the current target strategy, produced in 2001, also need to be revised. A new strategy should be based on strong analysis at country level of the blockages to service provision. These blockages include lack of financial resources – a key constraint in Africa – but also ineffective and poorly targeted resources. The strategy should be underpinned by DFID's own principles for aid effectiveness⁶ and by commitments made in the 2005 Paris Declaration⁷.

2.5 Water is not always given appropriate emphasis in DFID country programmes. In 2003, the NAO reviewed the extent of DFID's involvement in 20 countries with lowest levels of water access and found that there was 'little correlation between country spend and countries with the greatest water need'⁸. The design of country strategies is built around poverty reduction strategies, and yet this can be problematic when PRSPs have not had sufficient participatory inputs from, or respond to, the needs of the poor. WaterAid has found that poor people consistently name water and sanitation as a top priority in participatory poverty assessments.⁹ DFID needs to consider how to address such gaps and inconsistencies when country budgets are decided for 2008-2011.

3. Focus and delivery of bi-lateral assistance

3.1 According to the Atkins report¹⁰, almost one third of DFID's 2003/04 bilateral expenditure for the water sector went to Iraq. The report also pointed to a downwards trend in bilateral water expenditure in Africa, despite the fact that this is a region where there is minimal progress towards the MDG targets. In fact, if current trends continue, sub-Saharan Africa will end up with 47 million more un-served in 2015 than in 2004¹¹. As the Department seeks to re-focus its aid, it is essential that need rather than political expediency underpin spending priorities.

3.2 Budget support is one of DFID's increasingly favoured forms of aid delivery. The UK provides 32% of its bilateral aid to Africa in this form. A recent OECD/DAC evaluation¹² of this mechanism shows the impact of budget support on the delivery of basic services. On the plus side, budget support can lead to increased expenditure on PRSP priority sectors and an expansion of access to basic services. Budget Support can also strengthen central government ownership and control over a larger pool of resources for development. Although this is a positive development, it has led, in some cases to a disempowerment of local government. The OECD report found that although expenditure for basic services had increased as a result of budget support, the quality of basic services at local level had deteriorated. Ensuring that aid delivery mechanisms enhance the capacity of local government, who bear the responsibility for service delivery, is a key concern for the water sector.

⁶ Department for International Development, DfID's medium term action plan on aid effectiveness (2006)
<http://www.DFID.gov.uk/mdg/aid-effectiveness/default.asp>

⁷ Paris Declaration on Aid Effectiveness
http://www.oecd.org/document/18/0,2340,en_2649_3236398_35401554_1_1_1_1,00.html

⁸ National Audit Office, Department for International Development, Maximising impact in the water sector (2003)

⁹ See WaterAid's discussion papers on PRSPs,
http://www.wateraid.org.uk/uk/what_we_do/policy_and_research/documents_and_publications/discussion_papers/discussion_papers_on_prsps/default.asp

¹⁰ Department for International Development, Financial Support to the water sector, 2002-2004 (August 2005)

¹¹ WHO/UNICEF, Joint Monitoring Programme for Water Supply and Sanitation, Meeting the MDG drinking water and sanitation target: the urban and rural challenge of the decade (2006) http://www.wssinfo.org/en/40_mdg2006.html

¹² OECD/DAC, Joint Evaluation of General Budget Support (2006)
http://www.oecd.org/document/61/0,2340,en_21571361_34047972_33637693_1_1_1_1,00.html

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3.3 DFID's Water Action Plan 2004 says that solving the lack of incentives and prioritisation of water and sanitation by local authorities "is the real prize". In order to maximize the impact of its aid, DFID must ensure that strengthening the capacity of local government level delivery systems is a key priority. At the moment decentralization policy is often overreaching capacity. DFID needs to develop innovative new programmes that target the most chronic capacity constraints at local government level in order to reverse some of the deep weaknesses at this important delivery point in the sector.

3.4 Delivering aid in ways that enhance recipient government accountability towards citizens is a considerable challenge. A recent NGO evaluation of Budget Support¹³ has found that it has frequently strengthened the upward accountability to donors. National parliaments and civil society are often unable to track spending because of insufficient transparency and a dearth of disaggregated budgetary information. In many cases, dialogue around resource allocation is conducted behind closed doors by a small group of key policy makers and donor representatives. In those countries where DFID gives budget support, there should be a complementary strategy to strengthen local civil society to scrutinize budgets and policies and better articulate demand for water and sanitation services.

3.5 Given that in many of the countries where DFID works, water is not a focal sector, it would be strategic to use limited resources to further coordination between government, WSS donors and service providers. Resources could be wisely invested in the development of sector-wide plans and investment programmes developed through the creation of multi-stakeholder water dialogues. The Department can build upon the success of its experience in Uganda by promoting secondments of advisory staff within government water ministries or finance ministries. DFID staff could thus facilitate prioritisation of WSS in national plans and catalyse investment by governments and donors. DFID could also use its resources to support research into policy options which would provide better evidence for recipient government decision making, for example in urban reform programmes.

4. Multilateral channels

4.1 DFID is increasingly channeling water and sanitation financing through Multilateral Institutions (MIs), including the World Bank and the Regional Development Banks. In 2003-04 it is estimated that £76 million, 35 % of DFID financing for water and sanitation was channeled through MIs, up from £45 million in 1999-2000¹⁴. The actual figure is probably higher as DFID funding of specific multilateral projects is classified as bilateral support and the Atkins report appears to underestimate the proportion of MI spending on water and sanitation (for example, the report gives a 'water factor' for ADB as 4 % when ADB's water policy claims 19 % of lending for water sector¹⁵).

4.2 Given DFID plans to increase sector expenditure and pressures to reduce staffing levels, it is likely that the proportion and level of financing channeled through MIs will continue to rise in the future. Much of MI financing is in the form of loans. Given the bankruptcy and indebtedness of most urban public utilities in low-income countries, DFID needs to reconsider whether it is advisable that financing urban WSS investments in these countries is done through loans or through grants. Given the concerns outlined below, DFID needs to start to conduct analysis of the effectiveness of MI projects.

4.3 Many MI water and sanitation projects do not benefit the poorest and most vulnerable. Recent research by WaterAid shows that Asian Development Bank projects, resulted in unsatisfactory outcomes for the

¹³ Care/ActionAid, Where to now? Implications of changing relationships between DFID, recipient governments and NGOs in Malawi, Tanzania and Uganda (2006) http://www.actionaid.org/index.asp?page_id=1236

¹⁴ Department for International Development, Financial Support to the water sector, 2002-2004 (August 2005) <http://www.DFID.gov.uk/pubs/files/water-sector-finance.pdf#search=%22DFID%20financial%20support%20to%20the%20water%20sector%22>

¹⁵ Asian Development Bank, Water For All: The Water Policy of the Asian Development Bank (2001) <http://www.adb.org/Documents/Policies/Water/default.asp?p=policies#contents>

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poorest 16. The research found that despite overall increases in services levels, the poor were excluded from these benefits due to mechanisms adopted for project design, implementation and monitoring and evaluation. The research also concluded that the institutional capacity to sustain management and operations of water infrastructure is not addressed.

4.4 Multilateral organizations lend to the poorest countries at concessional interest rates. However, the study by WaterAid and research institutes in Nepal, Bangladesh and India, found that concessional loans for water and sanitation projects are on-lent by central governments to lower tiers of governments, and to communities, at increasing rates of interest¹⁷. This concessional funding finally reaches end borrowers with interest rates of between 8 and 14 percent per annum. These rates are far from concessional. DFID should work with the MIs to review practices of on-lending and introduce policies to ensure that this practice does not result in unaffordable services and increasing debt burdens at various levels.

4.5 Given the significant level of financial support provided to MIs for water and sanitation, DFID does not have adequate oversight of or influence over MI sector policies, programmes and projects. This means that MI projects can result in outcomes that are contrary to DFID policies. DFID can improve these projects by making wider use of Trust Funds in all projects to support poverty and social impact analysis prior to project implementation, mapping of the poor, and design of strategies for serving all poor and vulnerable groups. DFID should also consider placing more DFID staff with skills in pro-poor policy and service delivery in MIs. Engagement of country programme staff in project activities should be stronger. Finally, the replenishment rounds of MIs provide DFID an opportunity to push for pro-poor changes in project design, implementation and evaluation procedures and to make additional resources dependent upon improvements in these areas.

5. EU Water Initiative

5.1 DFID is leading a review of the EU Water Initiative (EUWI). General trends show that water and sanitation are receiving a declining share of European aid¹⁸. Allocable aid has fallen from 5.4% in 2000 to 4.1% in 2004. Most of this aid is directed towards middle income countries, with a mere 29% of resources going to Sub-Saharan Africa despite the fact that this is the region most off-track towards meeting the MDG targets. EU donor funding is often uncoordinated and results in inequitable coverage as well as undermining government administrative capacity. The EUWI was promoted as Europe's contribution to the achievement of the water and sanitation MDG targets. Unfortunately, the initiative has made little progress since it was launched in 2002¹⁹. DFID has a role to play in advocating through EUWI for an improvement in the quality, quantity and targeting of EU aid.

5.2 Two key aims of the EU Water Initiative were to reinforce political commitment to the sector and to improve national water governance by way of multi-stakeholder 'country dialogues'. However, the commitment of Member States has been weak and as a result the country dialogues have failed to get off the ground in all but a couple of countries. AMCOW members, civil society and member states have raised serious concerns about EUWI's performance. The DFID-led review must re-focus the initiative in order to meet its original objectives.

5.3 A key component of EUWI is the Africa Working Group. DFID should take a lead in shaping the strategy for this group. The Africa Working Group (AWG) must seek to improve information flows on EU WSS aid volumes and targets, gaps and overlaps, with a view to ensuring that countries in Africa that are off-track their MDG targets receive priority funding. The AWG can be tied more closely to political processes through an

¹⁶ WaterAid, Water For All? A study on the Effectiveness of Asian Development Banks Water and Sanitation Projects in Ensuring Sustainable Services for the Poor (2006) http://www.wateraid.org/documents/plugin_documents/adb_water_for_all.pdf

¹⁷ WaterAid, idem

¹⁸ OECD / DAC, Measuring Aid for Water, (2006) www.oecd.org/dac/stats/crs/water

¹⁹ WaterAid/Tearfund, An Empty Glass (2004)

http://www.wateraid.org.uk/documents/plugin_documents/euwaterdiscussion.pdf

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annual report to the European Council on EU commitments to the water sector. In addition to financial commitments, this would include commitments to increase advisory capacity, develop local expertise and strengthen local accountability.

5.4 At the country level, EU members need to give more robust support to sector coordination by funding the participatory development of national plans and the production of investment and performance reports. The lack of funding so far has been a prime cause of the failure of the country dialogues. DFID should ensure that the current review of EUWI considers how sector wide approaches can be enhanced by EU financing rather than undermined by it.

6. Private sector involvement in water and sanitation

6.1 Over the last 5 years, DFID has exerted much effort to establish financing facilities to encourage private sector involvement in WSS and other infrastructure in developing countries and to cover private sector risks²⁰. This flies in the face of evidence that the international private sector is not interested in investing WSS infrastructure, especially in the countries with most need. DFID needs to review the outcomes and effectiveness of these donor facilities at the very least.

6.2 Reform of public water and sanitation services so that everyone has sustainable and affordable access, is key to progress towards the MDG targets. WaterAid is against the imposition by donors of policy conditions on governments that force them to privatise services or to bring in the private sector as part of reform efforts. There is a coherent body of evidence that suggests reform efforts work best after national governments have examined all their options for delivering safe water, ensuring that whatever service is chosen, the poorest citizens will benefit. Citizens should be consulted and participate in the deliberation of these options to ensure that the best option on how to reform services is taken.

6.3 Although DFID no longer officially makes its bilateral aid conditional on PSP, the department continues to support the International Financial Institutions to do so. The World Bank, the IMF and the Regional Development Banks continue to impose conditions on developing countries to privatise systems without appropriate debate and discussion of the options at the national level. The one-size fits all approach they promote may not be appropriate to specific countries' needs or consider governments' capacities to regulate. As a result, access to services for the poor and vulnerable could diminish as prices rise beyond what is affordable.

6.4 DFID has placed too much emphasis on promoting private sector management of public utilities often in the face of widespread public opposition and government resistance. The department still has to recognise the need to rebalance policy and financial support in the light of experiences of successful public utilities and of failing public utilities that have been successfully turned around and remained public. More scope exists for DFID to use its assistance to enable public utilities to support each other, share knowledge and learn from each other's successes (in particular through public-public partnerships).

7. Transparency and Reporting

7.1 DFID systems for recording water-related expenditure are weak. With an ever increasing proportion of DFID sector aid being channeled through other organizations, especially multilateral institutions, more information must be made available on how much is being spent by these organisations, whether this spending is in line with DFID central policies, and what the results are for the poor. The WaterAid study on the Asian Development Bank found that monitoring and evaluation systems did not provide the information required to know if projects were benefiting the poor. DFID also needs to develop methodologies to monitor

²⁰ See appendix A of WaterAid submission on Urbanisation and Water

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how much budget support is spent in the sector. It is not sufficient to assume that recipient governments will spend the same proportion of budget support on water as the percentage originally set out in PRSPs.

7.2 Full disclosure of project information should be available on the DFID website. The 6-monthly update on the Water Action Plan gives some information on country programmes but does not always quantify contributions in financial terms, or make clear the link between programmes and progress in the sector. DFID country offices could usefully invest resources in making WSS project information available and accessible to people in developing countries who do not have access to technology. DFID should invest resources in helping pro-poor groups and the poor themselves gain access to planning processes and knowledge of their own entitlements by making information available through local media and in materials and languages accessible to the majority.

Key Recommendations to DFID

- Ensure that a target for departmental performance in the sector is included in the next Public Service Agreement. Update other policy frameworks (Target Strategy Paper and Water Action Plan) and set out a clear strategy for the scaling-up of support to the sector in line with White Paper commitments. Ensure that the new strategy has the full buy-in of country programmes and all directorates.
- Ensure that aid is delivered in ways that enhance recipient government accountability towards citizens. Where DFID gives budget support, there should be a complementary strategy to strengthen local civil society to scrutinize budgets and policies and better articulate demand for water and sanitation services.
- Develop innovative funding strategies that target the most chronic capacity constraints at local government level in order to reverse some of the deep weaknesses in service delivery at this level.
- Use limited resources to further coordination between government, WSS donors and service providers. Invest in the development of sector-wide plans and investment strategies developed through the creation of multi-stakeholder water dialogues. Promote secondments of advisory staff within government water ministries or finance ministries.
- Carefully consider the balance of the aid portfolio. Increases in multilateral aid should be accompanied by strengthened engagement with multilateral institutions to ensure that the policies and lending practices of these institutions are pro-poor and do not impose policy conditions.
- Develop advocacy towards EU governments for an improvement in the quality, quantity and targeting of bilateral aid to the water sector. Use the current review of EUWI to redefine the initiative as a high-level political space where EU donors as a body hold each other to account for commitments made, and where EU Member States jointly strategise with recipient governments to address obstacles blocking progress towards the MDGs.
- Review the outcomes and effectiveness of donor facilities created to facilitate multinational company involvement in WSS infrastructure, whether they lead to improvements in service and are pro-poor.
- Improve systems for reporting water-related expenditure. Strengthen the Update on the Water Action Plan to measure the impact of DFID programmes in developing countries. Develop communication and outreach strategies in-country.