

Agenda

**FINANCING AND PRICING WATER: THE ROLES OF GOVERNMENT POLICES,
THE PRIVATE SECTOR AND CIVIL SOCIETY**

OECD Global Forum on Sustainable Development

Agenda and Issues Paper – 1-2 December 2008

Day 1: Monday, 1 December from 09:00 to 18:30		
	08:30 – 09:00	Registration
1.	09:00 – 09:30	Meeting Opening
		Mr. Angel Gurría , Secretary-General, OECD
2.	09:30 – 12:30	Session 1
	09:30 – 10:30	Financing water and sanitation: Realistic strategies for developing and OECD countries
		<p>Chair: Mr. Maurice Bernard Agence Française de Développement, France</p> <p>Panellists:</p> <p>Mr. Michael Deane, US Environmental Protection Agency, United States</p> <p>Mr. Philippe Marin, The World Bank</p> <p>Mr. Mohamed Fadel Ndaw, Millenium Water and Sanitation Program (PEPAM), Senegal</p> <p>This session will discuss the financing of water and sanitation services. It will identify the challenge facing developing countries; discuss what policy options exist, and the approaches that have been used in OECD and developing countries to close the financing gap; and present good practices for promoting dialogue and building consensus on the measures required to achieve policy objectives. The session will focus on the ultimate sources of funding (i.e. user charges, taxes and ODA grants), rather than the financial instruments used to channel finance for large up-front investments.</p>
	10:30 – 11:00	Coffee Break
	11:00 – 12:30	Session 1 continued
	12:30 – 14:00	Lunch Break

3.	14:00 – 16:00	Session 2
		Tariffs for sustainable water services: Addressing trade-offs between policy objectives
		<p>Chair: Ms. Véronique Deli Chair of the Environmental Policy Committee's Working Party on Global and Structural Policies, Permanent Delegation of Mexico to the OECD</p> <p>Panellists: Mr. Jack Moss, AquaFed, the International Federation of Private Water Operators Mr. João Simão Pires, Instituto Regulador Águas e Resíduos, Portugal Mr. Gopakumar K Thampi, Public Affairs Foundation, India</p> <p>The objectives of this session are to (i) clarify the conflicts that may emerge between the various objectives faced by policy-makers when designing a tariff policy for water service provision, and (ii) discuss how different tariff structures respond to these objectives and the trade-offs among them. Particular attention will be given to the possible trade-offs between financial objectives and social considerations (affordability). The session will also address the importance of the tariff-setting process in the design and implementation of a successful, long-term tariff strategy.</p>
	16:00 – 16:30	Coffee Break
4.	16:30 – 18:30	Session 3
		Managing water resources: Sustainable management of water resources in agriculture
		<p>Chair: Mr. James Horne Department of the Environment, Water, Heritage and the Arts, Australia</p> <p>Panellists: Mr. Asit Biswas, Third World Centre for Water Management, Mexico Mr. Alberto Garrido, Universidad Politécnica de Madrid, Spain Ms. Marca Weinberg, US Department of Agriculture, United States</p> <p>The focus of this session is to examine the constraints, opportunities and challenges that decision makers face in designing policies to achieve the sustainable management of water resource use in agriculture. The discussion will take place against the background of recent trends and future projections for water resources in agriculture that highlight the growing importance of water stress; the economic, environmental, social and institutional dimensions of sustainable water resource use management in agriculture; and the policy experiences across OECD countries in moving towards the sustainable management of water resources in agriculture.</p>
	18:30 – 20:30	Cocktail hosted by Agence Française de Développement, France

Day 2: Tuesday, 2 December from 09:30 to 18:00		
5.	09:30 – 12:30	Session 4
	09:30 – 11:00	Is money enough? Public and private roles in developing and managing water infrastructure
		<p style="text-align: center;">Chair: Ms. Carolyn Ervin Directorate for Financial and Enterprise Affairs, OECD</p> <p style="text-align: center;">Panellists:</p> <p style="text-align: center;">Ms. Magaly Espinosa, Superintendencia de Servicios Sanitarios, Chile Ms. Huguette Labelle, Transparency International Mr. Gérard Payen, AquaFed, the International Federation of Private Water Operators</p> <p>This session will address the roles of public and private actors and the regulatory environment needed for sustainable service provision. While public financing and management remain dominant in the water sector, most countries have had some form of experience with private sector participation. The session will consider the diverse forms of private sector participation, the types of activities delegated to private actors, and the contractual arrangements used. The session will address two main issues:</p> <ul style="list-style-type: none"> • Increased money flows to the sector are not the only way to tackle the financing gap. The appropriate involvement of the private sector can help to resolve the financial challenge facing the water sector through reduced costs of service provision or more efficient management systems, which in turn may facilitate access to finance or increase service quality and thus also final users' willingness to pay. • Money is not enough: optimizing the contribution of all stakeholders requires the effective harnessing of capacities, which heavily depends on "getting the institutional set-up right" and adherence to good partnership practices.
	11:00 – 11:30	Coffee Break
	11:30 – 12:30	Session 4 continued
	12:30 – 14:30	Lunch Break

6.	14:30 – 18:00	High-Level Panel
	14:30 – 16:00	<p style="text-align: center;">Facilitator: Mr. Axel Threlfall, Reuters</p> <p style="text-align: center;">Panellists:</p> <p style="text-align: center;">Prince Willem-Alexander of the Netherlands, Chair of UN Secretary General's Advisory Board on Water and Sanitation</p> <p style="text-align: center;">Mr. Loïc Fauchon, President, World Water Council</p> <p style="text-align: center;">Mr. Angel Gurría, Secretary-General, OECD</p> <p style="text-align: center;">Mr. Edward Kairu, Chair, African Civil Society Network on Water and Sanitation</p> <p style="text-align: center;">Mr. Jeremias N. Paul Jr., Undersecretary, Ministry of Finance, Philippines</p> <p style="text-align: center;">Mr. Josep Puxeu Rocamora, State Secretary for the Rural Environment and Water, Ministry of the Environment and Rural and Marine Affairs, Spain</p> <p>The final session of the Forum will be organised around a policy dialogue among several high-level panellists. The session will open with a summary of the main findings from the OECD Water Programme and of the main issues emerging from the discussion over the previous day and a half. The presentations will provide the basis for the policy dialogue among the panellists and all meeting participants with a view to formulating a forward-looking vision regarding the challenges that face the water sector beyond the 5th World Water Forum in Istanbul.</p>
	16:00 – 16:30	<i>Coffee Break</i>
	16:30 – 17:45	High-Level Panel continued
7.	17:45 – 18:00	Meeting Closure

Issues Paper

Introduction

The objective of this meeting is to discuss the key policy conclusions and recommendations emerging from a two-year programme on water involving several OECD Committees and Directorates. Several analytical reports have been prepared and the results presented in a Synthesis Report, "Financing and Pricing Water: the Roles of Government Policies, the Privatesector and Civil Society" (ENV/EPOC/GF/SD(2008)1) that serves as the main document for this meeting.

This Issues Paper summarises some of the key findings and suggests issues for discussion. It presents issues following the same sequence as the main sessions of the meeting:

- Financing water and sanitation: realistic strategies for OECD and developing countries
- Tariffs for sustainable water services: addressing trade-offs between policy objectives
- Managing water resources: sustainable management of water resources in agriculture
- Is money enough? Public and private roles in developing and managing water infrastructure
- High-level panel

Discussion in sessions 1-4 will help to strengthen the presentation of issues in the main sections of the Synthesis Report. The session involving the high-level panel will help to fine-tune the overall policy messages in the Synthesis Report. Following the GFSD meeting, the Synthesis Report will be finalised and launched as a contribution to the 5th World Water Forum in Istanbul, 16-22 March 2009.

Background

Water is a key prerequisite for human and economic development, and for the maintenance of ecosystems. However, poor governance of water and sanitation services, and inadequate investment, is resulting in many people not having access to water services. Failure to manage water resources effectively is also resulting in increased pressure on, and competition for, water among different economic activities, as well as for the environment.

In OECD countries, access to safe water supply and sanitation has largely been ensured following investment over many decades. However, significant investments will still be required to rehabilitate existing infrastructure, to bring it into conformity with more stringent environment and health regulations, and to maintain service quality over time. For example, a recent OECD study estimated that Japan and Korea may have to increase their water spending by more than 40 percent to maintain existing levels of service

The most critical challenges related to water supply and sanitation are in the developing world. The international community is committed to the Millennium Development Goals (MDGs) that aim, *inter alia*, to halve the proportion of people without access to safe drinking water and basic sanitation by 2015. A 2008 monitoring report by WHO/UNICEF shows that almost 1 billion people still lack adequate access to drinking water, and 2.5 billion to adequate sanitation. A 2008 World Bank monitoring report showed that a majority of sampled countries are not on-track to meet the water-related MDG targets. Available evidence suggests that on current trends ("business as usual") the targets will not be met.

Inadequate access to safe water and sanitation, and poor hygiene, account for 1.8 million child deaths per year – the second largest cause of child mortality after malnutrition - as well as other adverse health impacts. The costs of inaction are very significant for the countries concerned. The World Health Organisation estimates that each dollar invested in water supply and sanitation generates between 4-10 dollars in health benefits alone. Achieving the water-related MDGs is critical for achieving other MDGs such as those on poverty reduction, education and gender. Globally, the

current level of investment in water and sanitation is not sufficient to enable these benefits to be realised.

Many parts of the world are suffering from increased competition for water, as water overuse and pollution reduce available sources. Increasing populations exert additional pressures. In 2005, 2.8 billion people were living in areas under severe water stress¹. The *OECD Environmental Outlook to 2030* estimates that this number will increase by about 1 billion people to 3.9 billion (47% of the world population) by 2030. The majority of the inhabitants of areas under water stress (2.3 billion) will be located in the BRICs – Brazil, Russia, India and China.

Establishing effective governance in the water sector is particularly challenging as it often cuts across the responsibility of several ministries, and requires the involvement of national, regional and local authorities. Moreover, many water issues cut across national boundaries. Addressing these challenges calls for institutions that can strike a balance among a range of economic, social and environmental objectives, deploy a mix of policy measures, and facilitate policy implementation at the appropriate level of governance. However, introducing reforms in the water sector – revising tariffs, reducing subsidies, engaging the private sector, redefining property rights- often generates political conflicts. Effective implementation strategies must therefore address the opposition of affected groups and vested interests.

¹ Where water withdrawals exceed 40 per cent of available water resources.

SESSION I

Financing water and sanitation: realistic strategies for OECD and developing countries

In many countries, the benefits from investing in water supply and sanitation, such as a healthier and more productive population, are not realised. Particularly in the developing world, water services are caught in a vicious circle of deteriorating quality, insufficient financial resources for operation and maintenance, and declining willingness of consumers to pay for low-quality services. Achieving the water-related MDGs will require significant reforms of governance systems, but also significantly increased financing. A recent WHO report estimates that USD 18bn will be needed annually to extend existing infrastructure to achieve the water-related MDGs, roughly a doubling of current spending. But what is also becoming clearer is that the cost of *maintaining and modernizing* existing systems will grow steeply and already exceeds the annual costs of extending the networks by several orders of magnitude.

In order to meet these challenges, the water sector needs to significantly reduce its costs by improving its operational efficiency, i.e. reduce leakage from pipes and energy use, and improve billing and collection rates. There is also a strong need for greater financial realism in sector plans, which are often developed on the basis of a political vision and not grounded in an analysis of the costs of achieving targets, and how those costs will be met. Sector targets and objectives need to be set so that they are affordable for households and public budgets. This may involve difficult policy choices about the service and coverage levels that can be achieved in a given period.

Achieving financial sustainability of the water sector requires finding the right mix of revenues from the so-called “3Ts”: tariffs, taxes and transfers (including ODA grants). These are the ultimate sources of finance for the sector and they need to increase to a level where they allow the recovery of costs. This will help to attract other sources of finance – such as loans (including ODA loans by bilateral donors and International Financial Institutions) and bonds. These additional sources of finance are important for making the large, up-front investments required in the water sector, and which must be repaid over time by some combination of the 3Ts.

While there is often significant scope to increase revenues from tariffs without exceeding households’ ability to pay, concerns about affordability nevertheless limit the use of tariffs to cover the cost of water services provision in some of the poorest countries. In these countries, public budgets and ODA will be needed for the foreseeable future to achieve financial sustainability.

Strategic financial planning can help to achieve consensus on some of these policy choices (e.g. the appropriate mix of tariffs, taxes and transfers). Ideally such planning processes should be led by Ministries of Finance and engage other relevant stakeholders. This can lead to a more rational use of existing financial resources and facilitate access to additional ones. Such processes are in-line with the Accra Agenda for Action and the Paris Declaration on Aid Effectiveness and donors can support them through capacity development and alignment of ODA.

Issues for discussion

- Why are the potential economic benefits of water and sanitation not being realized, and how can strategic financial planning help the water sector better access public and private financial resources?
- What is the best use of scarce public budgets and ODA to effectively support sustainable water and sanitation services?
- How can donors best support strategic financial planning processes, and what are the key capacity development needs in this regard?

SESSION II

Tariffs for sustainable water and sanitation services: addressing trade-offs between policy objectives

Requiring users to pay for water services they receive through appropriate tariffs is fundamental to achieving financial sustainability in the water sector. Tariffs account for the lion's share of recurrent expenditure in both OECD and developing countries. However, various obstacles limit the role that tariffs play; they include lack of awareness of the broader economic benefits of water services, especially sanitation; lack of well-functioning markets; and concerns about the impact on poorer households. Even in many OECD countries, where most households do not face affordability constraints, it is unusual for tariffs to cover the full costs of providing water and sanitation services, including the cost of replacing or extending infrastructure, let alone the opportunity and environmental cost of using the resource. But keeping tariffs artificially low may result in a vicious circle of low willingness to pay for water and sanitation services, underfunded service providers, insufficient investment, collapsing infrastructure and deteriorating services that further reduce users' willingness to pay for them. Collapsing water systems hurt lower-income users the most.

The key difficulty faced by policy-makers regarding tariffs is reconciling different policy objectives: financial sustainability of water utilities, environmental sustainability of water use, avoiding contributing to inflation and minimising adverse impacts on poor sections of the population. After many decades of "cheap water" there is often strong public opposition to tariff increases which makes politicians, especially at the local level, reluctant to approve tariff increases. Tariff-setting for water utilities is ultimately a political decision, and needs to be made through a transparent, democratic, participatory process. This requires a debate about the appropriate balance between the various policy objectives, assessing the costs and benefits of different tariff levels, examining the distributional impacts of tariff structures, and developing appropriate compensatory or mitigation measures to avoid affordability problems. Such debates are more likely to be effective if they include discussion of service quality and coverage as well as tariffs.

Financial sustainability and affordability of services are sometimes depicted as conflicting objectives and have generated polarized debates. Affordability limits need to be assessed at national/local/community level rather than relying on international affordability thresholds, e.g. 3-5% of household income. The latter do not take account of the actual willingness to pay for improved services of local populations, or other local characteristics that may require average tariffs to increase, e.g. specific local conditions leading to high recurrent costs, such as the need to pump water over long distances.

In reality, keeping tariffs low for everybody does not help the poor and especially those who currently do not have access to water services. Low tariffs prevent extensions of networks to poorer communities, forcing them to continue paying higher prices for water that may be of inferior quality to piped water. The solution to affordability constraints is not a low average tariff *level* for all, but instead a well-targeted, carefully-designed tariff *structure*. The design of tariff structures should be tailored to specific contexts and different services. For example, charging for water service is different from charging for sanitation services which provide public health and other benefits to communities beyond the direct users. Subsidising one-off charges for accessing networks is often considered a better strategy than subsidising consumption. Some countries use non-tariff mechanisms to provide relief for the poor, such as coupons or targeted income support. Their use, however, requires good data about income distribution and may entail significant administrative costs.

Issues for discussion

- What type of process and public debate are needed when setting and adjusting tariff levels, particularly when taking account of affordability constraints?
- How do different tariff structures perform compared to parallel, targeted income-support mechanisms in mitigating the impacts of tariff increases on poorer households?
- Who should pay for sanitation services that provide benefits to communities beyond the direct users?

SESSION III

Managing water resources: sustainable management of water resources in agriculture.

Agriculture is the major user of water so it is crucial that the sector faces the right signals to maximise efficient use. Charges for surface water supplied to farms have been increasing in most OECD countries. But often farmers are only covering the operation and maintenance costs for water supplied, with little or no recovery of capital costs for new water delivery infrastructure. Water pricing policies rarely take into account social or environmental impacts. Nor do they include the opportunity costs of water, although sometimes they are covered by other policies. Groundwater policies usually involve licences and other regulatory instruments, but illegal pumping is difficult to control and remains a major challenge for the sustainability of farming. Where countries have increased water charges to farmers, it has not led to reduced production.

Agricultural policies in many OECD countries that promote production encourage further inefficient use of water, lead to off-farm pollution and can exacerbate flood damage. There has been some progress in lowering overall agricultural support levels and in decoupling support from production and inputs (water and energy). This is beginning to encourage more efficient use of water, better adaptation to water scarcity, and lower off-farm pollution. Adoption of better farm practices can help flood mitigation and provide other environmental benefits such as wetland conservation.

Implementing water reforms is becoming more complex, for example with regard to achieving cost recovery targets, developing water pricing and trading, and changing water entitlements and institutional arrangements. As a result policies need to be underpinned by improved knowledge, research, training and advice, and monitoring. There is a lack of transparency of information on water supply costs. Developing water markets, and planning water allocation between different users and the environment, requires detailed monitoring of water extractions and flows. Better information on the costs and benefits of agriculture's use of water (e.g. groundwater recharge, wetland conservation, flood mitigation) would facilitate more informed decision making. Farmers also need more information and advice on the best practices to adopt.

Many OECD countries are reporting the growing incidence, severity and costs of flood and drought events on agriculture linked to climate change. As a result, many countries are developing mitigation and adaptation strategies. These include efforts to improve food security and water use efficiency by farmers in areas of water scarcity, to develop new crop or farm practices where climate change alters temperatures and precipitation, and to alter management practices that slow water transport across farmland and thereby reduce flood damage in urban areas. These approaches are more likely to be effective if they are embedded in longer-term strategies closely linked with risk management and market-based approaches.

Issues for discussion:

- Which developments in the future will have the most significant impact on the supply and demand for water in agriculture?
- What are the main constraints and opportunities in recovering the full supply costs of water in agriculture?
- Which actions could governments take to improve policy coherence that would most cost-effectively achieve policy objectives relating to the economic, environmental and social aspects of agricultural water?

SESSION IV

Is money enough? Public and private roles in developing and managing water infrastructure

Many countries have sought the involvement of the private sector to operate, modernize and expand their water and sanitation infrastructure. However, high capital intensity, large initial outlays, long pay-back periods, immobility of assets and low rates of return generate high risks. These factors, in a context of poor information and weak investment environments, limit the scale of private investment in water and sanitation infrastructure. Poor regulatory frameworks and inadequate contractual arrangements have also hampered private sector participation.

Recognising this, the OECD Council approved the OECD *Principles for Private Sector Participation in Infrastructure* in March 2007 and launched a specific application to the water and sanitation sector. The resulting *Checklist for Public Action* offers practical guidance to help governments and other stakeholders, particularly in developing countries to assess and manage the implications of involving private actors in the financing, development and management of water and sanitation infrastructure. It provides a coherent catalogue of policy directions for consideration by governments. It addresses the appropriate allocation of roles, risks and responsibilities, and the framework conditions necessary to make the best of private sector participation.

The *Checklist* recognizes that private sector participation in the water sector is very diverse, both in terms of the actors involved, the responsibilities that are delegated, and the contractual arrangements used. Whereas 10 years ago private sector participants in the sector were mainly large international water companies, today there is a wider variety of players: construction or engineering companies, industrial conglomerates seeking to diversify, private enterprises whose core activities are not water but are important users of water (such as beverage, mining and construction companies), local water companies expanding and going regional or forming joint ventures with international operators.

Concern over water resource scarcity is also stimulating the development of new technologies such as wastewater reclamation and re-use, desalination and advanced filtration membranes. In addition, in most developing countries, small-scale local actors have made up for the deficiencies in public service provision and provide water and sanitation service to the poorest sections of population.

Private participation in the water sector does not exclude a role for government. Most of the time, the public sector remains the owner of the assets and is responsible for the bulk of capital investment. In any case, government represents the public interest, including for water quality and for preventing abuse of a monopoly in supplying water services.

In recent years, many countries have increased their efforts to achieve regulatory stability and predictability. However, regulatory frameworks often remain incomplete, and the water sector in many developing countries is still characterised by unclear allocation of responsibilities across stakeholders, including across different government tiers and agencies. In addition, strong political commitment remains critical, notably in the fight against corruption, and in addressing water and sanitation poverty. Optimizing the contribution of private actors also heavily depends on adherence of all partners to good partnership practices. This involves grounding the partnerships in strong accountability mechanisms, including clear and consistent contractual arrangements, mechanisms that facilitate information sharing and disclosure, and an informed involvement of civil society (users, communities and NGOs). The *Checklist* addresses this double challenge: enhancing the enabling regulatory environment for water infrastructure investment, and making the public-private co-operation work.

Issues for discussion:

- How can private actors contribute to improved efficiency and investment in the water sector?
- What are the key features of the institutional and regulatory environment required to ensure the positive participation of the private sector in providing water and sanitation services?
- What are “good partnership practices” involving the private sector, government, consumers and other stakeholders?

HIGH-LEVEL PANEL

The Synthesis Report will contribute to the 5th World Water Forum in Istanbul, 16-22 March 2009. It is important therefore that the report presents clear, policy-relevant messages, particularly regarding the economic and financial aspects of water. Some of the key overall messages that are emerging from the report are:

1. Unless we fully account for, and seek to capture, the economic benefits from investing in water, there will continue to be under-investment in water services and resources management.
2. New and strengthened efforts are needed to achieve the MDGs. Strategic financial planning can play a role by helping to address issues such as: (i) enabling the water sector to make its case more effectively so that Finance Ministries allocate adequate resources to it (ii) using multi-year budget frameworks to create stable public finance for the sector (iii) enhancing the catalytic role of ODA (iv) and optimizing the role of tariffs.
3. The importance of getting tariffs right is crucial. Greater clarity is needed on the policy objectives that tariffs are designed to achieve, their real impacts on the poor, and the design of measures that are needed to mitigate affordability problems.
4. Policy-makers should move beyond debates on public versus private provision of water services and focus on *how* water services can be provided in the most cost-effective and sustainable ways. Governments, providers, communities, consumers all have a role and a responsibility in assuring that safe, affordable water services are provided to people in a sustainable manner
5. More effective ways to allocate increasingly scarce water among users need to be found. Water resources should be managed in a way that ensures sufficient availability for human and productive uses –including for food production in a time of concerns about food security- and protection and provision of environmental functions. This will require more effective coordination with policies in other sectors (including finance, energy, agriculture, tourism, and land management)
6. While the benefits of reforming water policies are widely recognized, implementing reforms encounters many formidable obstacles. Effective reform strategies therefore need to address the “political economy of reform”: how to overcome the opposition of vested interests, and those groups that may be adversely affected by reform, charting a roadmap and timetable to achieve the desired objectives, and communicating with stakeholders along the way.

Issues for discussion:

- What are the most important policy messages that the OECD Synthesis Report should transmit to the 5th World Water Forum in Istanbul?
- How should those messages identified above be modified or changed?
- What impact will the financial and economic crisis have on reforming the water sector?