



## Pro-poor Design of Subsidies for Drinking Water and Sanitation Services in Africa

(based on the *African Economic Outlook 2007\**)

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- ◆ Limited capacity to pay, large infrastructure needs and a huge backlog in the construction of sanitation facilities make recourse to cross-subsidies and government-funded subsidies a necessity in Africa.
- ◆ On-going support for defraying the monthly costs of providing drinking water and sanitation services to the poor must be combined with subsidies for the initial cost of connection in order to increase access more rapidly.
- ◆ Financial sustainability requires long-run funding of subsidies, their efficient use by better targeting the poor, and adopting output-based criteria.

Numerous governments in developing countries provide subsidies to facilitate access to drinking water and sanitation services, especially for the poor, and to increase the benefits associated with these services, such as improvements in public health.

Subsidies for the poor are usually funded either by government or by higher-income consumers. Government-funded subsidies are provided through direct cash transfer to households or through financial support to the utility against a commitment that this will be reflected in lower prices to low-income consumers. This requires, however, that the utility be capable and willing to pass on the subsidy to the poor. Consumer-funded subsidies take the form of cross-subsidies, where some users subsidise others. In the water and sanitation sector, this usually takes the form of cross-subsidisation between wealthier and poorer users, subsidisation across water and sanitation and clear differentiation of the polluting industries which should bear the costs of pollution abatement according to the "polluter pays" principle. Cross-subsidisation is not at odds with the cost-recovery principle as long as the average tariff is set to ensure the financial sustainability of the provider without recourse to government support. Such schemes usually imply unit tariffs that increase progressively with higher levels of water consumption; thus, they require an efficient metering system to monitor consumption levels and the prevention of illegal connections.

At present, however, very few water utilities are financially sustainable in Africa as highlighted in the *African Economic Outlook 2006/2007* and various World Bank studies. Even in urban areas, tariffs rarely fully cover all operating and maintenance costs, not to mention charges for capital raised to finance investment. In Northern Africa<sup>1</sup>, for instance, only the water utilities in Rabat and Casablanca fully cover their operating costs in this way. More typically, in Cairo and Alexandria tariffs are estimated to cover only 25 per cent of operating costs. The challenge remains great since even in richer areas, families might not be wealthy enough to afford the resulting tariffs. And in the specific case of sewerage and wastewater treatment, charges are usually set at only 20 to 30 per cent of their actual costs. Consequently, most water utilities rely on subsidies, not only for network expansion and modernisation, but also for recurring expenditure.

Subsidies may be given for the initial cost of connection, for consumption on an on-going basis, or both. Consumption subsidies in the form of progressive tariffs with increasing levels of water consumption are, however, detrimental to large families, to groupings of families (to which the poorest might resort) and to water-intensive SMEs.

1. See for instance World Bank (2007), *Making the Most of Scarcity: Accountability for Better Water Management Results in the Middle East and North Africa*.

Moreover, subsidising services helps the poor only if they have access to water in the first place. Otherwise, consumption subsidies become counter-productive as they leave little funding for extending infrastructure to the unserved.

Helping the poor in areas where connection rates are low can be more efficiently accomplished by subsidising connections to drinking water and sanitation facilities, rather than providing on-going support for consumption. However, subsidies that lower investment costs might not be sufficient to help poor households to acquire a connection since there may also be non-financial obstacles. Land and property titling can be an issue, as well as the growing informal tenancy that has accompanied rapid urbanisation in Africa. If the cost of providing and maintaining sanitation are not factored into the rent, poor tenants have little incentive to develop facilities in places they do not own, while the landlord is only likely to provide a crude structure.

Evidence from the 2007 *African Economic Outlook* shows that implementing subsidies for the poor requires:

- Balancing efficiency and equity to maximize the impact on the poor while taking account the financial constraints – a multi-stakeholder decision-making process involving policy makers, civil society representatives, utilities and poor communities may help as shown by the success of the community approach in Ghana.
- Strengthening the capacities of smaller local providers, as they are often the best placed and the most interested in supplying remote markets, but may have difficulties to comply with national technical and financial requirements. In Uganda, for instance, the National Water and Sewerage Corporation has partnered with the Directorate of Water Development to train the local private sector in how to meet national standards.
- Ensuring sustainable long-run funding of subsidies, through more predictable donor funding and budgetary allocations. A mechanism, such as the Zambia's Devolution Trust Fund, has for instance helped mobilise more predictable funding to enable utilities to extend their services to the peri-urban poor.
- Targeting the subsidy to the poor, either through self-selection – through quantity or service-level targeting (i.e. on the basis of how much or what quality a household consumes) – or through administrative selection. Targeting areas where the majority of poor households are located could help avoid the recognised difficulties in identifying and reaching target groups.
- Tying subsidies over time to performance and outputs. In that perspective, Output-Based Aid as developed by the Global Partnership on Output-Based Aid (GPOBA) since 2003 has proved instrumental to improve service quality and lower costs, allowing increased coverage. In Mozambique, for instance, GPOBA is contributing towards subsidising 36 300 new connections, thereby increasing access by 23 per cent just in Maputo.

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