OECD GLOBAL FORUM ON SUSTAINABLE DEVELOPMENT:

FINANCING WATER AND ENVIRONMENTAL INFRASTRUCTURE FOR ALL

Paris, December 2003

Financing Water for All: Introductory Remarks

James Winpenny

As an initiative of the Global Water Partnership and the World Water Council, and with the support of the 3rd World Water Forum, M. Michel Camdessus was invited to lead a Panel of high-level personalities representing international finance, development agencies and other realms. Its task was to propose ways of increasing the flow of finance into the global water sector, in its broadest sense.

This was the first time international water finance had been addressed in a comprehensive fashion. The Panel's Report contains a coherent philosophy and set of principles, and many detailed proposals for improvements, in the two broad domains firstly of water governance and secondly of financial instruments and facilities. The Report has been widely recognised as an authoritative statement of the "state of the art" and has become a reference point and yardstick against which all parties can measure themselves.[1]

Some of the main points are:

- The Panel adopted the attainment of the Millennium Development Goals as the main medium-term goal, and urged all parties, governments, donors, MFIs[2], NGOs, etc. never to lose sight of this as their main performance target over the next 12 years or so.
- National public funding is, and for the foreseeable future will remain, the main source of investment finance for this sector in many countries. National governments should raise the priority of the water sector in their national investment strategies and improve the predictability of their funding for it.
- Donor governments and external agencies should aim to make "substantial increases" in the share of water in their total commitments, improve the coordination of their activities in the water sector and use their funds as catalysts to mobilise other flows.
- Sub-sovereign entities, such as municipalities, regional water boards, water utilities, etc., were identified as crucial in the campaign to raise more finance. This entails reform, to make these bodies more creditworthy, facilitating technical assistance of all kinds, promoting appropriate types of private involvement, making central fiscal support more predictable and transparent, helping such bodies to tap capital markets directly, etc. MFIs should review their policies with a view to increasing sub-sovereign lending.

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1 E.g. the World Bank's Consultative Meeting with other IFIs, September 2003.

2 Multilateral Financing Institutions

- Water projects can be complex and problematic, and are often too small to attract ordinary project finance. Transaction costs are high. To help overcome this, Revolving Funds should be created to fund the public preparation and structuring costs of complex projects. “Best practice” and “model” clauses should be written for legal agreements, especially those involving private participation.
- Foreign exchange risk is one of the main deterrents to the use of external finance for water, and is difficult to mitigate under current arrangements. Local capital markets should be encouraged as a source of local currency funds, by such means as the use of credit rating agencies for local borrowers, issue of local currency bonds by MFIs, use of guarantees and other forms of risk mitigation by MFIs, strengthening of development banks and other local financial intermediaries, etc. A new Devaluation Liquidity Backstop Facility is proposed for piloting.
- Better cost recovery from users is vital. However, full cost recovery is unlikely to happen soon in all cases, and in the meantime many governments will continue to subsidise water service providers. The Panel espoused “sustainable cost recovery”, consisting of improved efforts to raise revenues from users, with residual subsidies applied in an predictable, transparent and targeted manner.
- The water sector lacks credible and effective institutions. Many proposals are addressed to governments, donors, agencies and others involved in a position to affect capacity-building in water institutions. Options include the direct funding of relevant forms of partnerships (both public-private and public-public), creating trust funds for financing expertise, support for training, professional exchanges, peer-group scrutiny, etc.
- The Panel took a pragmatic stance on the best organisational model for the water sector in particular cases, though recognised that a number of countries are keen to tap the expertise and capital of private operators. In such cases, the various parties should work within a clearly defined and transparent policy framework, including regulation of both private and public operators. Integrity standards should be developed amongst the interested parties and the award and implementation of contracts should be fully transparent. Donors, agencies and governments should be open to financing water projects by combining public funds with private financing in transparent and acceptable ways. A special effort should be made to involve local private companies, including small-scale operators.
- Much financing occurs at the grass roots as a result of local initiatives and using local credit sources. A proposal is made to study how Decentralised Funds might be created to assist these efforts.
- Governments and other key parties should be held to account for their commitments and performance, against the MDG criterion. Donors and MFIs should report on their performance in relation to commitments. A “control tower” and group of “wise persons” should provide international monitoring.

The momentum continues:

In the short time since the Report was presented at the Kyoto Third World Water Forum, the world water landscape has already changed. Some of the milestones have been:

- World Bank/IMF Development Committee paper ("Implementing the World Bank Group Infrastructure Action Plan") in April;
- G8 meeting in Evian, June, produced a Water Action Plan addressed to the international community;
- IFC formed a new Municipal Department to develop its programme of sub-sovereign lending;
- World Bank hosted a consultative meeting for MFIs in September to review their policies and practices in the light of the Panel's report.[3]
- Inter-American Development Bank starts series of regional workshops on water financing, November
- UN Secretary-General agrees to form an independent Eminent Persons Group reporting to himself, November
- OECD Global Forum, Financing Water and Environmental Infrastructure for All, December

Setbacks and disappointments

In certain respects, the water landscape has changed for the worse. Since the euphoria of the Monterrey Conference on the Finance of Development and the Johannesburg World Summit on Sustainable Development, both in 2002, there has been a slackening of donors' interest and will to support the water sector. The start of the Iraq War during the very week of the Kyoto Forum heralded a shift of political interest, and budgets, to other things. ODA for the water sector continues to decline, and external funding for this sector is probably at its lowest level since the 1980s.

Commercial lending and private investment are also in the doldrums. In the wake of a series of setbacks after the Asian debt crisis in the late 1990s, including September 11, 2001, devaluations in Argentina and elsewhere, nervousness about the solvency of a number of banks, and the impact of the Basel II Accord, commercial banks are highly risk-averse. Lending to emerging markets, and for water projects in particular, is currently at a low ebb. Investment by foreign private operators is also dwindling. The pool of companies with the capacity and the will to invest overseas has shrunk, and many of those who entered overseas ventures in the 1990s are now licking their wounds.

The general view of lenders and donor agencies is that there is a low level of investment in the water/wastewater sector, and as a result little demand for finance. This is, of course, a generalisation, but one that rings true for many observers. There are various possible reasons for this. There are many conflicting priorities for national

[3] Consultative meeting to follow up on the G8 request to the World Bank regarding the IFI recommendations in the Report of the World Panel on Financing Water Infrastructure, Sept 8, 2003.

government investment, a high level of indebtedness, poor creditworthiness of sector institutions, the fact that water investments can readily be postponed, etc. It is also true that the supply of finance influences the demand for it- recipients would make greater efforts if they knew that funds were available on attractive terms.

The Panel's lasting contribution, and how to build on it

For probably the first time, water financing has been (and is being) dealt with in a more comprehensive and coherent way. Water sector people are confronting and working with financiers at a suitably senior level: water has a place at the High Table. The Report provides a reference point and checklist of actions for agencies. There are hopeful signs that the new Eminent Persons Group will become a Champion for water at the highest level, and bring some leadership to the UN system, in which water is currently an orphan. A number of agencies are keen to expand sub-sovereign lending. The international financial infrastructure for water has been refurbished and is ready for use.

Keeping up the momentum depends, above all, on measures to improve the *governance* of the sector, and raising the capacity of its institutions. Water and wastewater do not deserve to be the Cinderellas of the economy. Fully half the proposals in *Financing Water for All* are devoted to governance measures of various kinds. There are no quick fixes, but we have to start somewhere, and synergies can quickly develop. Better governance is the key to raising investment in this sector. Increasing effective demand for finance would quickly follow.