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Financing Water

Toward an L20 Action Plan

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By Nigel Purvis and Nalin Sahni*

The Vision

Over the past century, industrialized nations have pioneered a tried-and-tested approach to financing water infrastructure expansion: raise local capital by issuing long-term debt that can be repaid with revenues collected for services provided to new customers. Because the consumer benefits of safe drinking water and sanitation greatly exceed the cost of capital in developed nations, water projects are self-financing and -sustaining. Unfortunately, the situation in developing nations is very different. The cost of capital is far higher in poor nations because capital is scarce and water infrastructure investments entail significant political risks. Because even under the best of circumstances, donor funding for clean water domestic, agricultural and industrial use. Though environmental factors must be taken into account through policies that promote conservation and intelligent water basin management techniques, there is more than enough water to provide clean water and sanitation to the poor.

Yet, after decades of development assistance, fully 1.1 billion people still lack access to safe drinking water and 2.3 billion people do not have access to adequate sanitation. International funding for water, moreover, is declining. Why is this the case? At the risk of oversimplifying, water projects in developing nations are exceptionally difficult to finance because they are expensive and risky; local capital is scarce; and the benefits are primarily local. As a consequence, politicians tend to shy away from the issue because they fear they cannot deliver.

Expense

The resources required to provide safe water and sanitation to all ($10-15 billion annually) are significant. Although it may be tempting to ask donor nations to carry most of this burden, some L20 donor nations are unlikely to support a donor driven approach. From 1999 to 2001, the annual average of global official development assistance for safe water and sanitation was $3 billion, representing a $500 million drop from 1996-1998 levels. An entirely donor driven effort would require about a 400% increase in water assistance and a reversal of recent trends. While the global benefits of providing clean water to all ($63 billion annually by one estimate) easily outweigh the costs, as a practical matter relying disproportionately on foreign assistance is probably politically infeasible given competing development goals and domestic priorities. Although the global benefits of safe water and sanitation are large, the local benefits and incentives are far greater. A more realistic solution is to mobilize the resources of developing nations, which naturally have the greatest stake in expanding access to safe drinking water and sanitation to their own citizens. While donors need to do more than they are today and the L20 should play a role in building political will for them to do so, the ultimate solution – one that is durable and self-sustaining – must be found within developing nations given the level of expenditures required to build and maintain drinking water and sanitation systems.

Capital Markets

Even leaving aside enormous costs and high interest rates, developing nations tend to have difficulty raising money because their domestic capital markets tend to be poorly developed. Many developing nations lack the legal infrastructure, public disclosure or technical know-how necessary to operate well-functioning equity or bond markets. These governments have few alternatives to capital markets. Their treasuries are stretched and insufficient to finance major infrastructure projects. Large portions of their economies are in unregulated and untaxed 'grey markets' or 'informal sectors', so developing nations have few options for raising new revenues. Local citizens in developing countries cannot or will not lend to their they have over water systems, and see nationally- or internationally-backed expansion projects as potential risks to existing water revenues. In short, leaders at all levels of government find the status quo of slow but manageable progress less threatening than many bolder alternatives.

Elements of an L20 Communiqué

Financing safe drinking water and sanitation for all will be difficult even under the best of circumstances. Any proposed L20 solution must create a compelling vision that will mobilize political support in all countries. To make dramatic progress both donor and recipient nations will have to agree to do more. The best use of limited foreign aid (even at substantially increased levels) is to help developing nations attract the much larger pools of private capital needed to solve the drinking water and sanitation problem. The L20, therefore, should focus on creating the conditions for this to occur. Specifically, the L20 should work together to:

- Minimize the political risks associated with water projects in the developing world;
- Spread the remaining risks in an efficient, equitable and commercially reasonable manner;
- Create in poor nations well-functioning capital markets (both debt and equity) for water infrastructure and utilities; and
- Build political support at all levels of government for needed policy reforms, including significant increases in water-related foreign aid by donor nations, and major water policy and pricing reforms in developing countries.

be transferred to the GWF or programmed in support of its activities. This is critical because President Bush is unlikely to ask the Congress for new foreign aid monies outside of the MCC.

Subsidize Private Rates of Return. To make private capital more affordable to developing nations, the GWF should supplement the interest rate on local water bonds and/or provide partial repayment guarantees. The repayment guarantees should only cover non-commercial risks such as political interference, expropriation, currency inconvertibility and deflation, war and civil disturbance. The GWF should require developing country national governments to guarantee loans or bonds issued by domestic water authorities in their country. In exchange for partial repayment guarantees, the GWF should also encourage multinational water contractors to receive some deferred payments either through equity participation in water projects or developing country bonds. This too would reduce the cost to developing nations. These policies would reduce the risk premium th

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The extent and type of reforms needed will differ from one country to the next. The GWF should be indifferent whether the water authority is publicly or privately owned or managed as long as the water service delivered is efficient and equitable. Recognizing that a one-size-fits-all approach would not be effective, the GWF should tailor the terms of its funding to reflect local needs and conditions by negotiating with developing nations country-specific implementation agreements that would guide project implementation.

Expand Service in Ways that Unlock Dead Capital. Aside from lacking access to clean water and sanitation, the poor often do not have legal property rights to their assets such as their homes and places of business. Since the poor do not have title to real property, they cannot convert these assets into liquid capital that could be used in socially beneficial ways, such as expanding water services. Also, the poor often have difficulty connecting to water systems because utilities are reluctant to provide service to buildings without proof of ownership and payment guarantees. Since the poor are the principal beneficiaries of expanding access to clean water and their assets are grossly underutilized, the GWF should pursue policies to help unlock and pool their assets as this would not only help with water and sanitation but also provide large sustainable development dividends in other areas. The GWF should fund community-based property surveys, as well as the creation of local land-use registries for slums and other informal property arrangements. Understanding ownership (in the practical sense) of the slums will help make it possible to provide piped wp Understaneal(Also)6.35(wphD0.001f)n t.i(opeit)-8((6

The proposed L20 strategy stands a good chance of success and broad acceptance because it would benefit all key players. The world's poorest citizens would secure reliable access to water and sanitation services at lower prices. The property surveys and registries required to deliver water would also move the poor a step closer to government recognition of their informal property rights. Private investors would profit from higher rates of return and partial guarantees against political risk. Water authorities and municipalities would increase revenues through higher prices and more customers. National governments in poor nations would receive enormous credit for alleviating poverty and promoting economic growth. International donors would achieve their humanitarian objectives at an affordable cost and limited risk. They would also have confidence their funds would be used wisely because grants would be directed initially to top performing nations, which in turn would create incentives for lagging countries. The United States, potentially the most reluctant L20 donor participant, could find the approach attractive as it is an extension of President Bush's own private sector-oriented and performance-based approach to foreign aid. This in turn would increase the chance that other donor nations would sign up as well.