Water in the Green Economy in Practice
Session 3: Sustainable Financing

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The Human Perspective

A green economy aims to improve the environment for the sake of human wellbeing

Investing in environmental assets will help us meet poverty goals; reduce hunger and disease; and reduce the incidence of death from pollution

Green Goals and Water

- To drive sustainability and growth in parallel
  - **Integrate use of natural and physical capital**

- To use water and energy more efficiently in production and consumption
  - **Reuse; water productivity; fit for purpose design**

- To reduce waste and greenhouse gas emissions
  - **Reduce subsidies; hydro as renewable energy**

Investment Needs to Achieve the Goals

- Green Growth Global WSS investment requirements for capital and O&M costs: $311 billion through 2050 (UNEP)

> The sector must not only **attract more funding**, but must **reduce inefficiencies** to make better use of the limited financial resources available

Challenges in the How: Green Design, Implementation, Scaling-up, Financing

- Structural path dependency difficult to change
- Lack of harmonization across sector policies
- Perverse policies promote inefficiency
- Existing design criteria is not pro-green
- Lack of incentives for improved performance, innovation, technology transfer
- Inefficient use of sector funds
- Inability of service providers to access finance

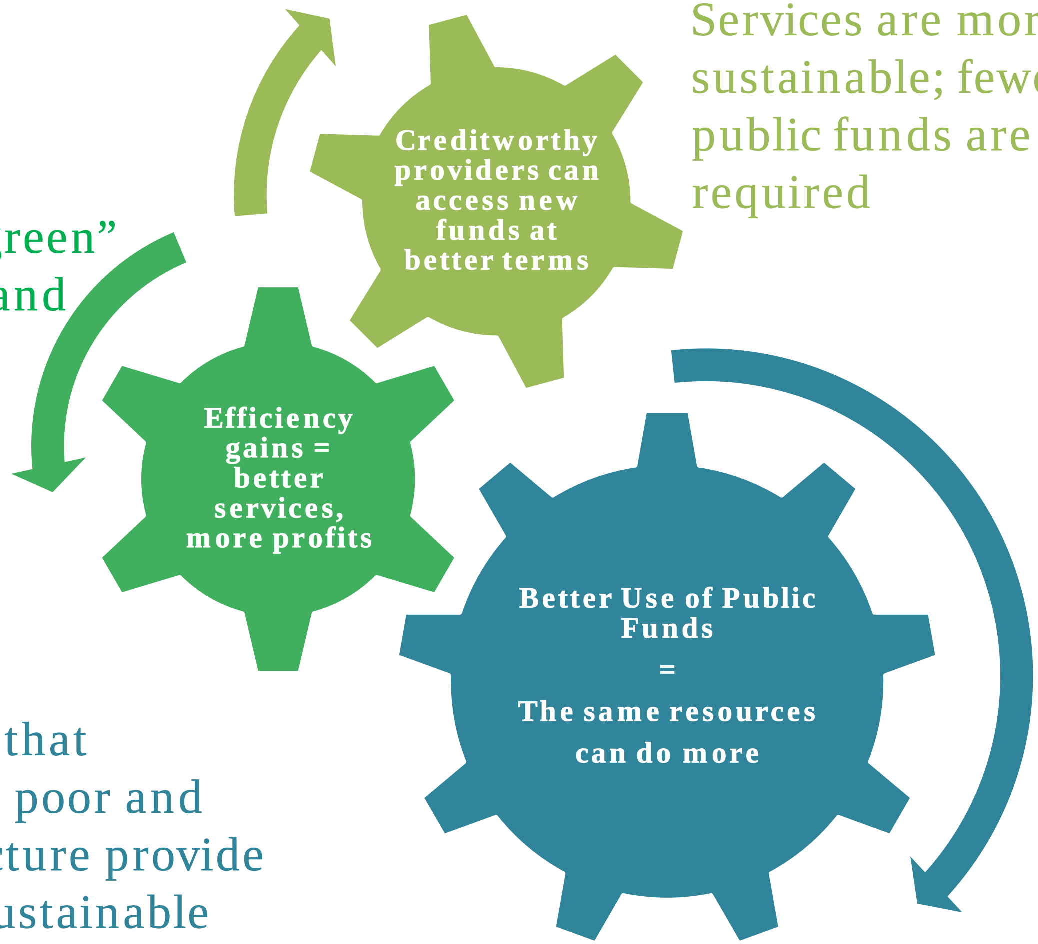
Financing the Gap: A Path to Improved Delivery of Service

1. **Governments:** identify efficiency of public spending and make needed adjustments
2. **Service providers:** reduce inefficiencies to improve cost recovery and reduce water/energy losses
3. **Tap new funding sources:**
   - **Use ODA, RBF, PPP options**
   - **Tariff reform to reflect the real financial, resource and environmental costs of service**
   - **Improved profitability = more access to funds**

The Upward Spiral

Better services improve willingness to pay; justify “green” tariffs that reflect financial and environmental costs

Services are more sustainable; fewer public funds are required



Public expenditures that effectively target the poor and build vital infrastructure provide the foundation for sustainable service delivery

1. Improve Efficiency and Efficacy of Public Spending in the Sector

- **Public Expenditure Reviews (PERs)**
  - Uncover the actual level of sector allocations and identify bottlenecks that impede appropriate and effective use of public funds
- **Targeted Subsidies**
  - Reach the poor and promote efficient use of water and energy
- **Results-based Financing**
  - Provide incentives for efficient use of money, materials and time

What is a PER?

- **A PER is concerned with the <u>allocation, management, and process</u> of public expenditure for the sector or sub-sector**
  - **Efficiency, effectiveness and equity of resource allocations**
  - **Reviews institutional framework, organizational capacity, and daily expenditure management**
- **New generation also incorporates quasi-fiscal deficit: value of implicit subsidies (underpricing, collection, NRW)**

Core message: A sector-focused PER can help a Line Ministry "make its case" to the Ministry of Finance

Ministry of Water

(sector policy, etc.)

- Spending
- Outcomes

PER links spending to outcomes

Ministry of Finance

(fiscal policy, etc.)

- Budget allocation

2. Reduce Inefficiencies in Water Services

- **Technical inefficiencies**
  - **Non-revenue water, energy efficiency**
- **Managerial inefficiencies**
  - **Corruption, billing, collection, pricing signals, project preparation**
- **Sectoral inefficiencies**
  - **Sector governance, management**
- **Regulation and investment climate**

Eliminating inefficiencies could generate almost 0.8 % of GDP in savings, annually

Potential (annual) Savings from Eliminating "Hidden Costs" [(1)]

Source of potential savings (annual)	**Lek millions**
A- Collection failure (improve collection ratios from 70 to 95 percent)	835
B- Under pricing (raise tariffs to cover O&M costs from 70 to 100 percent)	857
C- Excess losses (reduce NRW from 69 to 20 percent) [(2)]	5,042
Total Savings	**6,734**
As share of GDP	***0.8%***

(1) Using methodology developed in ECA

(2) Reducing technical losses will require significant investment

3. Additional Financing

What is Results-based Financing (RBF)?

- A tool that enables beneficiaries to control service performance
- An incentive for providers to reach the poor (otherwise they risk low cost recovery)
- An opportunity for the poor to connect to a network at low cost
- A strategy to reward service delivery once quantity and quality are independently verified
- A way of sharing risk with the private sector
- An incentive for providers to pre-finance their work

RBF: Lessons from Experience

- **RBF includes a variety of innovative options, used in many sectors, such as carbon finance and conditional cash transfers**
- **Three cases presented here:**
  - **Output-Based Aid**
  - **Social Contracts**
  - **Pro-Poor Financing**

Case 1: Output-based Aid (OBA)

- **Services for Informal Settlements: Morocco**
  - Connections were needed in peri-urban areas but willingness to pay was too low
  - OBA scheme: 60% was paid upon connection; 40% after 6 months of quality service delivery
  - Operator now delivers connections without subsidy
  - WB scale-up program is being planned for cities
- **Lessons Learned**
  - Operators strengthened relationships with local authorities through promotion activities
  - Quarterly independent technical review improved accountability and prioritized monitoring

Example 2: Social Contracts

- **Naandi Foundation, India: 25 Rural Villages**
  - PPP Fee-for-Service model was developed for small, grant-based pilot projects
  - Community contribution:
    - **land, water source,**
    - **20% capital costs, and**
    - **an electricity tariff**
  - Naandi can now borrow from commercial Banks
- **Lessons Learned:**
  - Paying for good performance transfers the financial and procurement risk to the service provider
  - Strong support from local village council was key

Example 3: Pro-Poor Financing

- **Medellin, Colombia**
  - Municipality provides long-term credit at low rates for the poor to connect to networks, finance home improvements and buy efficient appliances
  - Customers can also buy services from community organizations for construction and O&M of their systems
- **Lessons Learned**
  - OBA schemes are custom made and not easy to transfer
  - Effectiveness should be tracked through constant M&E
  - Fraud can limit the effectiveness of the program
  - Investments in social capital generate positive externalities and economic development
  - Credit is not the solution when it does not contribute to income generation or savings for consumers

For Discussion...

- **What are the major challenges and incentives for using results-based financing rather than input-based schemes?**
- **What regulatory and institutional challenges did you face during the design and implementation phase?**
- **Does results-based financing really promote sustainable service delivery in the long-run?**
- **What are the main 3 recommendations that could be provided to any other government and/or operator to ensure the implementation of results-based financing?**