

## Plenary: Multistakeholder dialogue on tools for implementation of the water-related Sustainable Development Goals

### *Session: Financing and Economic Instruments: Key tools and lessons learnt from implementation*

Session report, 17 January 2015

#### Introduction

Economic Instruments (EIs) have been recognized as essential means to achieve water related SDGs thanks to their capacity to encourage sustainable consumption and production, to mobilise investments in capital and technology towards sustainable activities and to provide adequate incentives and support to innovation.

The session was chaired by Hanna Leckie, OECD Division of Climate, Biodiversity and Water, She reminded all about the importance and magnitude of financing requirements to achieve the SDGs and mitigate the potential effects of future water crisis; remarking that the bottlenecks are not in the availability of functional economic instruments, but in the adequate selection and implementation.

The panellists of the session were:

- Jack Moss, Senior Advisor at Aquafed,
- Niels Vlaanderen, Senior Policy Advisor, Ministry of Environment, The Netherlands,.
- Moez Allaoui, Senior Legal Desk Advisor at Waterlex,
- Colin Green, Professor in water economics at the Middlesex University (UK),



*Discussion panel: from left to right, Niels Vlaanderen, Moez Allaoui, Hanna Leckie, Colin Green and Jack Moss.*

# Lessons on Financing and Economic Instruments: Stakeholder Perspectives

## 1. Lessons from Business

Jack Moss highlighted some of the concerns, priorities and contributions of Business to the achievement of the SDGs, especially emphasizing the importance of balancing the price and costs of water provision to ensure a reliable and sustainable service.

### ***You don't get anything for nothing, and the costs of 'not' having the services are very high***

The business sector has realized that nothing is free: you get what you pay for; and a reliable service provision pays off in terms of having the required amount, quality and timing of water supply, given that the costs of failures in provision ("the costs of not") are very high. They are thus willing to pay and see water priced sustainably. But it is not all about the willingness to pay; ability to pay and willingness to charge are also required. The great majority of the users have ability and willingness to pay for a decent service. There is need to provide solutions for this minority who cannot afford the service, but they should not be taken as the benchmark for establishing water tariffs. Willingness to charge, on the other hand, is not as obvious as it may seem, as water pricing is a political issue, but successful implementation examples show it works.

### ***A low investment - low perception of value loop***

One of the main challenges highlighted was the need to turn the actual system, where costs exceed the revenues leading to a deficient service with low value perception, into a sustainable system where costs and revenues are balanced and allow a good service that is positively perceived. The financial problems in the water sector were associated to a business case failing to promote water projects efficiently rather than to a lack of capital for investment. Low funding starts a vicious spiral that ends in a low perception of value and this perverse cycle has to be reverted.

### ***Narrowing new concepts and approaches: 'what you treasure you will measure'***

Some positive messages towards the SDGs were the approach to develop tools to have quality data and measurements that revert in a valuation of the resource: 'what you treasure, you will measure'; and the introduction of some new useful concepts like the TOTEX, which refers to a coherent management of CAPEX and OPEX. Jack Moss remarked the need to precise that water itself, may be a common good, but the services and benefits it delivers have to be paid for.

### ***Key financial instruments: the two and a half Ts***

We need to consider the importance of two of the three Ts: tariffs and taxes – the instruments that are paid by the users - as the pillars for achieving a sustainable financial system in the long term. Transfers and donor funding (the third T) may be less sustainable. Nevertheless, water projects need a very high upfront investment that has traditionally been covered by transfers. Concessional funding, bonds or loans were identified as possible promising alternatives to perform this bridge function.

## **2. Lessons from governments**

Niel Vlaanderen highlighted some of the concerns, priorities and contribution of Governments in relation to financing, as well as the perceived role they need to play for the achievement of the SDGs. He highlighted the need to distinguish what we need financing for: for WASH, for flood management, for risks management, for infrastructure, for water quality. In fact financial aspects of risks have received less attention during the debates than that for WASH or water quality. There is a need for creating a catalogue of existing financing tools available for each theme. This should facilitate both dialogue and decision making.

### ***The main barriers for financing: political will and institutional barriers***

According to the GLAAS report, most of the countries consider that finance is insufficient to address the challenges of sanitation. But in some cases the main barriers are not the availability of funds, but rather the lack of political will, the political capture of funds and the institutional barriers to mobilize financial resources, together with the existence of fragmented markets. In this sense, public participation and increased awareness is necessary to increase political priority, put pressure and create commitment for the mobilization of funds.

### ***Extended access to WASH requires sustainable business models for service delivery that can cover their costs***

Governments emphasized the potential role of the private sector in contributing to fill the financing gap. Sustainable business models that can provide good quality services are a critical ingredient to achieve the WASH goals, but those can only be possible by applying cost recovery and fair water pricing mechanisms. Meanwhile, low prices entail low incentives for innovation and upgrade of infrastructure, leading to a perverse loop of infrastructure degradation swelling the investment gap and increasing the vulnerability against water related risks.

### ***The costs of not acting are a lot bigger than investments required for prevention***

With regards to financing and water related risks, costs of not acting are a lot bigger than investments required for prevention. A focus on preparedness, mitigation and adaptation is a condition for success to ensure the security and resilience of communities and their economies. They are less costly than emergency reaction. Besides, assessments of the costs of post-disasters remediation do not usually include droughts, as it is a slow process, but the costs caused by prolonged droughts can be substantial.

### ***Comprehensive evaluation and assessment beyond project level***

Going beyond project level in the assessment and dissemination of results of successful financial models is important to upscale successful initiatives. The performance of transparent evaluation analysis including not only the financial aspects but also the environmental cost is important to assess sustainability. Comprehensive evaluation systems are a useful and necessary to assess progress though it is not something attractive for politicians due to their costs. .

### **3. Lessons from civil society**

Moez Allaoui, highlighted some of the concerns, priorities and contribution of civil society in relation to financing the SDGs.

#### ***Civil society is aware of its role: to push towards resource mobilization, equity and transparency***

Civil society is aware that achieving the SDG goals requires funding and global resource mobilization, which is not easy in the context of the present economic crisis. To advance in the way forward, all actors have a role to play, and participation of civil society is essential to ensure the fulfilment of their rights; the arbitrage and control of governance performance, particularly in the management and allocation of funds; the public access to information and the fight against discrimination, especially regarding women, youth indigenous and vulnerable people. This includes claiming for the right to decent access to good quality water and sanitation, protection against disasters and fair and sustainable management and distribution of water resources.

#### ***The viewpoint of the civil society on other stakeholders related challenges and obstacles***

There may be obstacles for water financing posed by governments, both at national and local level, including existing legislations and policies, inefficient resource allocation; deficient transparency and communication of information communication, and complex and inefficient bureaucratic and administrative procedures.

The obstacles identified for donors include action detached from communities; preconceived solutions that are not always adapted to reality; inadequate dissemination of information; lack of projects follow up and coordination between donors; and lack of funding to the NGO's working in the field.

The private sector's main constraints identified were the design of inappropriate projects and the lack of transparency, sustainability and respect for human rights – in some cases-.

The main obstacles from communities include lack of trust to women and youth initiatives, and the need for further awareness, capacity, involvement, willingness to pay and financial means.

#### ***Positive examples of tools to help overcome the obstacles***

Regarding funding tools, some initiatives like seed funding, self funding through the payment for services, revolving funding through micro finance or donor platforms have prove to be successful examples of sustainable financing tools. A remarkable condition for success identified was the need for institutions to get involved in the process of implementation.

In terms of management tools, local cooperatives, multistakeholder partnerships including small scale local companies, public authorities and civil society associations, the involvement of users, the association of several NGO's to achieve common targets or in projects, and initiatives promoting training, communication and integrity within the communities were successful examples.

### ***Tools dissemination and duplication is important to expand and upscale success***

The SDGs are not targeting only WASH but also IWRM, where transboundary water bodies play an important role. International cooperation around the SDGs is essential and strongly conditioned to international cooperation. International agreements and conventions are important tools to encourage the dissemination of existing knowledge on successful initiatives and instruments among regions. However, only a minority of countries have ratified the global frameworks (UN 1997 Convention and UNECE 1992 Convention). The Aarhus convention is also an important instrument for civil society to fully play its role through the right to information, public participation and access to justice.

## **4. Lessons from academia**

Dr. Colin Green highlighted some of the concerns, priorities and contribution of the academia in relation to financing and economic instruments in an attempt to “*see if indeed academia people can be turned into useful human beings for society*”.

### ***Combining financing with economic instruments looks like an attempt to breed lions and zebras.***

There are risks in combining financing with economic instruments, as it involves an attempt to look for the easy way: expecting to get from a revenue stream a secure low cost method to collect sufficient money to cover all the costs, without changing anything in the system. However, the inherent purpose of an economic instrument is to change people’s behaviour, so having a pricing system that is fully aimed to control water demand will probably result in a null final revenue collection due to a fall of the demand.

The main economic issue of water management is that it is very capital intensive, requiring high upfront investment, this means cost curves with a high initial peak followed by slow and long tails of revenue recovery. Economists’ responses would be in this case that marginal cost-pricing is not the solution, as it is required that marginal costs exceed the average costs, including the payment of the loans, and that is only possible through the rising of tariffs to the detriment of the poorest. So there is need to think about the two separately.

### ***Looking at the past to learn from experience: those who do not learn from history are condemned to suffer the failures of history***

A good way to find answers is to look at the strategies high income countries have used to finance their water systems in the last 100 years. It was essentially done through loans that were repaid using a very secure revenue collection system, with help of some crossed subsidies.

### ***Learning from failure is necessary for innovation in successful economic instruments***

Economic instruments, meaning mainly prices, subsidies and trading, have so far tended to underperform in practice. However, failure is an inherent part of the innovation process, and there is need for constructive learning from ‘successful failures’ which show you what to modify to achieve success.

### ***The biggest challenge for the water sector: finding economic instruments that make groundwater use sustainable***

Groundwater captures about 70 times the amount of global rainfall than surface bodies and has been unsustainably used and overexploited worldwide. Finding an economic instrument

that transforms groundwater extraction in something sustainable and profitable, and can be transferred to developing countries, is the greatest challenge.

***Best examples of water allocation and markets are found in arid areas where scarcity is a daily and long term companion***

Markets need to have internal differences e.g. between consumers and producers, and the greater the differences the greater the potential for gains from exchange. The use of water markets has not been done very effectively, with the usual water market examples being used are those of Australia and Western US where the water allocation system is rather dysfunctional. However we need to turn to the best water allocations examples, usually in arid climates such as the Arab regions, due to their extended experience in dealing with water scarcity.

***Charging farmers for water does not bring votes - Subsidies create addiction***

The role of reservoirs to storage and make water available for allocation is very important but this investments can only be maintained by engaging all users, including farmers. However, charging farmers for water is perceived by governments as counterproductive to get electoral support, and thus rarely done.

Subsidies have proved an effective instrument in many cases. However, they create a permanent expectation and long term dependence and once created they are very difficult to stop.

***The mystery of the failure of prices to change users' behaviour in the case of water***

Industries and commerce have proved to be able to reduce their water consumption by 20% and increase their profitability. The reason why higher water prices did not drive generalized action in this direction was that water costs have been a very small percentage of input costs, compared to energy and other resources, and thus neglected. The positive lesson is that driving the attention of industry and commerce to value their water costs and especially reliability is the way to engaging them to reduce their water consumption.

In terms of irrigation or household consumption, the evolution of demand when you increase price tends to show that irrigation prices need to increase and be sufficiently high to make agriculture uneconomic to make any difference in water consumption. Current water prices would need to double to drive a change in household consumption patterns. Doubling water prices is politically unviable, so there is a need to find alternative ways.

Understanding the hydrological reality and the human reality is the only way for economists to find the answers for a sustainable water financing, management and use system.

***Contributions from the open discussion: The role of NGOs and the challenge of the economics of co-action***

***There is need for stakeholders to understand the role of NGOs in order to find ways for win-win cooperation***

NGOs have the primary role to monitor and audit public policy performance and challenge governments to ensure the fulfilment of human rights and the provision of basic services to the communities. However, NGOs may be acting in competition with one another to pursue these goals: competing for funds, for proving results and for proving themselves useful.

NGO's need indeed funding to implement their activities and fulfil their roles. However, when they get funded by governments for the provision of certain services, they may be aligning with government goals, and they may lose their independence and capacity to challenge them.

Despite competition among NGOs, some examples of NGOs working together like in the case of Myanmar can be found. In some countries like the Netherlands they are also playing an active role and participation in the water management decision making processes. These examples should serve as a model to be replicated and rolled out.

From the business viewpoint, there is need to understand the segmentation in the NGO community, and the essence of their role in challenging other stakeholders in order to find the motivation and incentives for Business to work in collaboration with them.

### ***Water is a perfect case where coaction is essential***

The water sector is a particular case where coaction is fundamental. Governments have the role of good water management and protect the public interest, beyond individual interest. But a government cannot work efficiently without the collaboration of Business, NGOs as representatives of public perception and monitoring on the performance of public policies, and from the users as the receptors and potential financers of public services. There is need to understand the interdependences of these actors and their roles, responsibilities, capacities and power, to find the ways and create incentives for mutual cooperation.

It is getting clear that coaction among stakeholders in the field of water management is fundamental to achieve sustainability, but incentives and economic and financing solutions to make it an attractive and financially viable possibility need to be developed. Given the failure of the 'economic sciences' to provide a solution for this financial challenge - whereas it has a theory for competition there is no one for coaction - efforts to fill the gap of the economics of coaction are being done to make it possible.

### ***Can the history of developed countries be replicated in providing cheap and quick development to water and sanitation infrastructures?***

There are many factors that influenced the history and evolution of water and sanitation services and management in the 19<sup>th</sup> Century. Eg. in England there was a mix of utilitarianism, moralism and practicality, summed to particular funding conditions based on the concession of loans with very cheap and long-term return conditions to municipalities that are not comparable to the conditions that private companies face at the moment. Another example tried in India has been municipal bond markets.

Despite the present debate is usually focused on whether there is too much or too little savings available for investment, the key lies in mobilizing and maximizing the available funds for the different types of investments required by the water sector. Water and sanitation investments are low risk and low return, like the type of investments of pension funds for instance. But the most important is to define the type of project that is to be funded and what the particular policy objectives are (water provision, water savings, etc.) in order to find effective solutions. Generally reality tends to be simplified into a one-fits-all scheme. Defining the objective and designing more sophisticated financing package that select the most appropriate and suitable instruments for each particular problem could lead to cheaper and more effective solutions.

### ***Is the water sector taking women and youth into account in the design of sustainable projects?***

There are different international resolutions on the need for inclusion of women and youth in projects and decision making, there are also recommendations and resolutions that encourage companies to adopt human rights approaches and apply measures against discrimination of women and youth within their business. Therefore there are advances and actions towards the avoidance of discrimination.

### **Final messages emerging...**

Reaching the water related Sustainable Development Goals will be beneficial for those directly affected and for building a more equitable and prosperous society. Achieving the new water related SDGs would require investing 1% of GDP (Human Development Report UNDP), an average of USD 20 billion per year. But paying for water services is out of the reach of the poor and according to the 2014 GLAAS report, 77% of countries have insufficient financing for basic services provision alone.

Besides gathering new financial resources, it is also important to use those already in place better – more efficiently. Efficiency must go beyond building new facilities to guarantee their effective use and replacement. Between 20-40% of the resources may have not been applied to its intended purpose due to deviation of funds.

Some new and expanding opportunities to bring more financial resources to the water agenda come from nexus of water and energy, food and climate change adaptation. An important opportunity may be, for example, the new Green Climate Fund to support country actions delivering adaptation and mitigation. Improving use of resources through results-based contracts and output-based aid are also being extensively used by UN system organizations such as the World Bank. This includes using existing aid to provide collateral and warranties designed to attract private capital to risky projects – including local community projects and supporting the establishment of local credit systems.

Many of these smart financing mechanisms are only possible when accompanied by better governance, enhanced capacities and properly adapted technologies. In fact many are only possible if there are appropriate tariff systems and institutional and regulatory frameworks in place. However, in practice the willingness to charge tends to be lower than the capacity to pay.



## **Annex: Highlights on financing and the post 2015 process**

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During the stock taking meeting of Intergovernmental Negotiations on the Post-2015 Development Agenda of 21 January 2015 one overriding message on means of implementation and Global Partnerships was that it will be impossible to deliver on the ambition of the SDGs without an even higher level of ambition in terms of means of implementation and global partnership. There is an inherent interconnectedness of our two processes. There are parallels between the topics covered in Goal 17 and the main chapters of the Monterrey Consensus and Doha Declaration.

### **Options proposed by the Committee of experts on SD Financing**

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[http://www.un.org/ga/search/view\\_doc.asp?symbol=A/69/700&Lang=E](http://www.un.org/ga/search/view_doc.asp?symbol=A/69/700&Lang=E)

The Intergovernmental Committee of Experts on Sustainable Development Financing delivered its report on options for an effective sustainable development financing strategy in August 2014. The Committee proposed a basket of more than 100 options for policymakers, together with recommendations for a global partnership that encompasses key aspects of aid, trade, debt, taxation and financial market stability. It recommended individual, country-owned financing strategies, rooted in enabling national policy environments and complemented by a reformed international enabling environment. It recognized that all sources of financing would need to be employed, public and private, national and international.

The Report of the Open Working Group of the General Assembly on Sustainable Development Goals of August 2014 highlights some of the following

[http://www.un.org/ga/search/view\\_doc.asp?symbol=A/68/970&referer=/english/&Lang=E](http://www.un.org/ga/search/view_doc.asp?symbol=A/68/970&referer=/english/&Lang=E)

### **National resources and efficient use of existing financing**

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However, each country has primary responsibility for its own economic and social development and the role of national policies, domestic resources and development strategies cannot be overemphasized. Developing countries need additional resources for sustainable development. There is a need for significant mobilization of resources from a variety of sources and the effective use of financing, in order to promote sustainable development. In the outcome document, the commitment to reinvigorating the global partnership for sustainable development and to mobilizing the resources necessary for its implementation was affirmed.

Strongly encourage countries to consider using innovative ways to raise additional resources to fund sustainable development at scale, drawing from a number of options, including various tax (for example, financial transaction taxes, carbon tax on airline ticket levies) and non-tax (for example, emission allowances) mechanisms

There are strong calls to reform international trade, ensure effective regulation of markets and financial actors and to take vigorous action to fight corruption, curb illicit financial flows, combat money-laundering and tax evasion and recover stolen and hidden assets.

### **Stimulate Access and development of financing institutions**

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Policies are needed to stimulate and support entrepreneurship and to increase access to finance for small and medium-sized enterprises, including through the use of development banks and other financial intermediaries.

Countries should strive to provide universal access to financial services, emphasizing

inclusive access across income, gender, geography, age and other groupings. Specific barriers to women's access to finance should be eliminated. Countries should expand financial literacy and establish strong consumer protection agencies.

### **Blended financing platforms**

Blended financing platforms could have a great potential, particularly where there is a benefit to the public sector. Where they are considered, however, it is important to ensure that these arrangements are subject to safeguards in order to verify that they contribute to sustainable development. They must not replace or compromise State responsibilities for delivering on social needs. Such policies also need to ensure fair returns to the public, while incorporating social, environmental, labour, human rights, and gender equality considerations. In addition, risk should be managed through diversification and the use of multiple simultaneous projects, allowing for gains in some projects to offset losses in others.

### **International financing aligned to SD and avoid fragmentation**

Member States may wish to call on the international financial institutions to consider establishing a process to examine the role, scale and functioning of multilateral and regional development finance institutions to make them more responsive to the sustainable development agenda.

While the additional commitments that have been made for climate finance should be honoured, the use of these and other financing flows should not lead to fragmentation but rather to coherence and strengthened cross-linkages within the pillars of sustainable development. An expert technical group should be tasked with developing and presenting to Member States a coherent framework that accounts for climate financing and ODA.

### **The role of south south cooperation**

South-South cooperation and the significant efforts of solidarity by emerging economies is encouraging. More countries will need to commit to increasing their contribution to international public financing and set targets and timelines to do so. In turn, South-South technical assistance and the sharing of experiences through regional forums should be promoted.

### **Financing regulations**

We must vigorously implement comprehensive and adequate financial regulations in all countries, as the risk of another global financial crisis has not been sufficiently reduced. However, the design of regulations needs to take into account their impact on financial inclusion and incentives for investment in sustainable development.

### **The third Conference in July 2015**

The substantive outcome of the third International Conference on Financing for Development, in July 2015, will assess the progress made in the implementation of the Monterrey Consensus and the Doha Declaration.