Official Development Assistance vs. Market Based Mechanisms
A Debate on Financing Water Supply and Sanitation Services in Small Towns

Date: 21 August 2006 (Monday)  |  Time: 17:00 - 18:45 PM  |  Room: Folkets Hus, Room 300

A debate to explore the pros and cons of grants and soft-loans, market-based approaches, and everything in between, as they relate to the challenges of financing small towns.

The Facts

Between 2002 and 2004, ODA commitments to the water sector (globally) nearly doubled. Over the past few years, private charities and multi-national corporations have announced millions of dollars in funds to support basic needs of the poor, including water supply and sanitation, particularly where linked with health outcomes. In an era where attention to financing for the water sector is growing, discussions on adequacy of overall water sector finance, the ability to leverage local sources (ie users, domestic banks), absorptive capacity at decentralized levels of water governance, and donor harmonization/coodination are frequent.

On the other hand, abundant liquidity in local financial markets in developing countries, plus increased interest by financiers for transactions, has led to discussions on new approaches to financing the sector. Terms like guarantees, equity, microfinance, and output based aid have entered the jargon alongside traditional grants and concessionary loans.

Discussions around financing for networked/non-networked, rural and urban services tend to address different issues and sources of finance. In between are small towns, which tend to be located on the border between urban/rural or peri-urban/urban areas. According to the World Bank, a third of Africa and Asia’s population lives in either large or small towns. Basic population projections suggest that population in towns world-wide will likely double in 15 years, and double again in 30 years.

Discussion Points

■ Does ODA crowd out market based approaches?

In essence, ODA is cheap money – provided whether through grants or concessionary loans. There is some evidence that this cheap money can “crowd out” efforts by communities towards more market based approaches. For example, in Kenya, there are cases of small town communities organizing themselves to self-finance water projects, and saving upwards of 20% of capital costs. With the arrival of “free” money or in kind donations, mobilization of community savings plummeted. Likewise, some organizations that seek to facilitate market-based and ‘bottom up’ approaches have noted difficulties entering markets in countries where grant-based (whether through bilateral agencies or NGOs) approaches are dominant.

■ Are market-based mechanisms appropriate for low-income countries?

Although the potential for market-based approaches for the water sector have achieved greater attention in recent years, the importance of social networks (and hierarchy), strength of institutions and governance/rule of law, prevalence of formal and informal financial services, and other factors are critical. In low income countries, where the per capita income is only slightly higher than estimated per capita costs for water and sanitation services, the potential for market-based approaches is still unclear and untested, particularly for scaling up. Some of the challenges with a market based approach include evidence that individuals and households, once levels of disposable income afford, tend to prefer cell-phones and electricity over water and sanitation services. There is further evidence that given the revenue generation that can be associated with cell-phones and electricity, lenders prefer these sectors over water and sanitation.
How can ODA effectively lever market based mechanisms?

In recent years, calls for guarantees and the creation of revolving funds to stimulate investment in the water sector have increased, resulting in the creation of such funds in many middle income countries. For small towns, which pose considerable governance and capacity risks, these mechanisms could be very useful to increase the attractiveness of water and sanitation investments, particularly to support local utilities, small scale private entrepreneurs, and financial intermediaries (whether domestic banks, micro-credit funds, or, if regulation allows, NGOs). Still, the practical application of these mechanisms can be challenging. Given the poor levels of capacity at sub-sovereign levels of governance, and issues of inflation, debt ceilings, and currency risk (if the ODA is structured as a loan), guarantees can be expensive. Further, revolving funds require repayment of debt in order to revolve, which may be an issue for many utilities.

Should ODA be used as a market-based mechanism?

Discussions on how ODA should and should not be used have been conducted for nearly as long as ODA has been in existence. In the water sector, and specifically in small towns, the potential use of ODA as a market based mechanism may pose some administrative as well as functional challenges. For example, despite efforts by donors to reduce grant funding in favour of concessionary and even market-based finance, recipient government agencies are hesitant to give up the ‘free’ hard currency. Many NGOs that advocate for increases in development assistance call for more grant-based financing and the cancellation of previous donor debt. Hence the political economy of aid – from both donors and recipients – should factor into a discussion about the use of ODA as a market based mechanisms. This is highly relevant for the water sector, where the use of ODA to bolster microfinance for water projects, or to support local currency guarantees and financing, are increasingly taking hold in the imaginations and activities of water sector actors.

Is the MDG rush for outputs hampering sustainable finance?

The MDGs’ 2015 deadline for water and sanitation targets sets a focal point for donors, in terms of financing amounts and programs. In the countdown to achieve the MDG targets through new services, it is important to remember that 15-50% of the new services will likely have broken down due to the lack of capacity and support structures to maintain services over time. Post conflict countries are particularly at risk, as those that cannot quickly produce outputs will be left behind.

The Debate

To focus the discussion, this inner/outer circle debate will convene experts working on small town WSS financing, to argue opposite viewpoints.

Participants

Convenors: Bert Diphoorn, Chief, Water, Sanitation and Infrastructure Branch, UN-HABITAT
Paul van Koppen, Director, IRC-International Water and Sanitation Centre

Facilitation: Dominic Waughray, World Economic Forum

Inner circle ODA: Dr. William Muhairwe, National Water Corporation Uganda (to be confirmed)
Dr. Richard Franceys, Cranfield University, UK

Inner circle MBM: Moses Banda, K-Rep Bank, Kenya
Yasmina Zaidman, Acumen Fund, US

Outer circle: Martin Walshe, EUWI – European Union Water Initiative
Dr. Cyrus Njiru, African Development Bank
Rose Osinde, Consultant
Mamadou Dia, Senegalaise des Eaux (SDE), Senegal
Kameel Virjee, WSP – Water Supply Programme
Prabha Khosla, Consultant
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