



# Financing WASH: how to increase funds for the sector while reducing inequities

Position paper for the Sanitation and Water for All Finance Ministers Meeting  
April 19, 2017

# Executive summary

This Position Paper addresses three key issues that are receiving limited attention in the water and sanitation sector discussions on finance:

1. The lack of finance for strengthening the enabling environment
2. The untapped use of micro and blended finance
3. The inequities in allocation of finance in the sector

These issues require urgent attention from Ministers of Finance as they work with relevant ministries to develop financing strategies that will enable their respective countries to meet the ambitious targets set forth in Sustainable Development Goal 6 (SDG 6).

In addition to achieving SDG 6, direct outcomes of addressing these key issues include the following desirable impacts:

- Infrastructure that is maintained and lasts, so that people can be confident that they have regular, reliable access to water and sanitation services
- The sector becomes more attractive to much-needed additional private and public financing
- The poorest and most neglected benefit from public finance investments

The main areas of focus highlighted by this Position Paper are the following:

## 1. The lack of finance for strengthening the enabling environment

- Investment in the enabling environment is required for:
  - Improved quality and sustainability of water supply and sanitation services
  - Attracting more finance to the sector by signaling to financial markets that water and sanitation investments provide a similar, not greater, risk as compared with other investments
- When planning to meet SDG targets, finance ministers, line ministers and service providers should budget for the recurrent costs of maintaining existing services and should assume that these will be at least of similar magnitude to capital expenditure per year. The sources of funding might vary, but these costs should be accounted for when preparing budgets and developing sustainable asset management plans at sub-national levels.
- Investment in public resources, leveraging private money to fund capital investments, is an efficient and effective use of scarce government resources. This provides an opportunity to attract private funds and improve risk/reward profiles.

## **2. The untapped use of micro and blended finance**

- Governments should encourage their financial sectors to prioritize socially-oriented microloan products via regulations to enable larger proportions of low-income populations to access WASH. This allows governments more efficient use of their limited budgets.
- Government policies and investment practices should facilitate investment from domestic and international investors and from private users themselves. Effective combinations of policies and practices can catalyze household, utility, and sector-level financing models that crowd in private funding to increase coverage more quickly and sustain services over time.

## **3. The inequities in allocation of finance in the sector**

- In lower- and middle- income countries, public finance is an underutilized method for reaching the poor with water and sanitation services, despite the fact that this is the funding vehicle uniformly used across higher-income countries.
- More resources and political will are required to track public spending flows to understand where they are going, who is benefitting, and why some populations are not reached. To achieve SDG 6, this ability to track and monitor financial flows needs to inform public policy to ensure that public spending is efficiently directed and targeted toward sustainable water and sanitation services.
- More redistributive tax and tariff systems, and aid that is targeted more strategically, are needed to reach the areas and populations most in need.

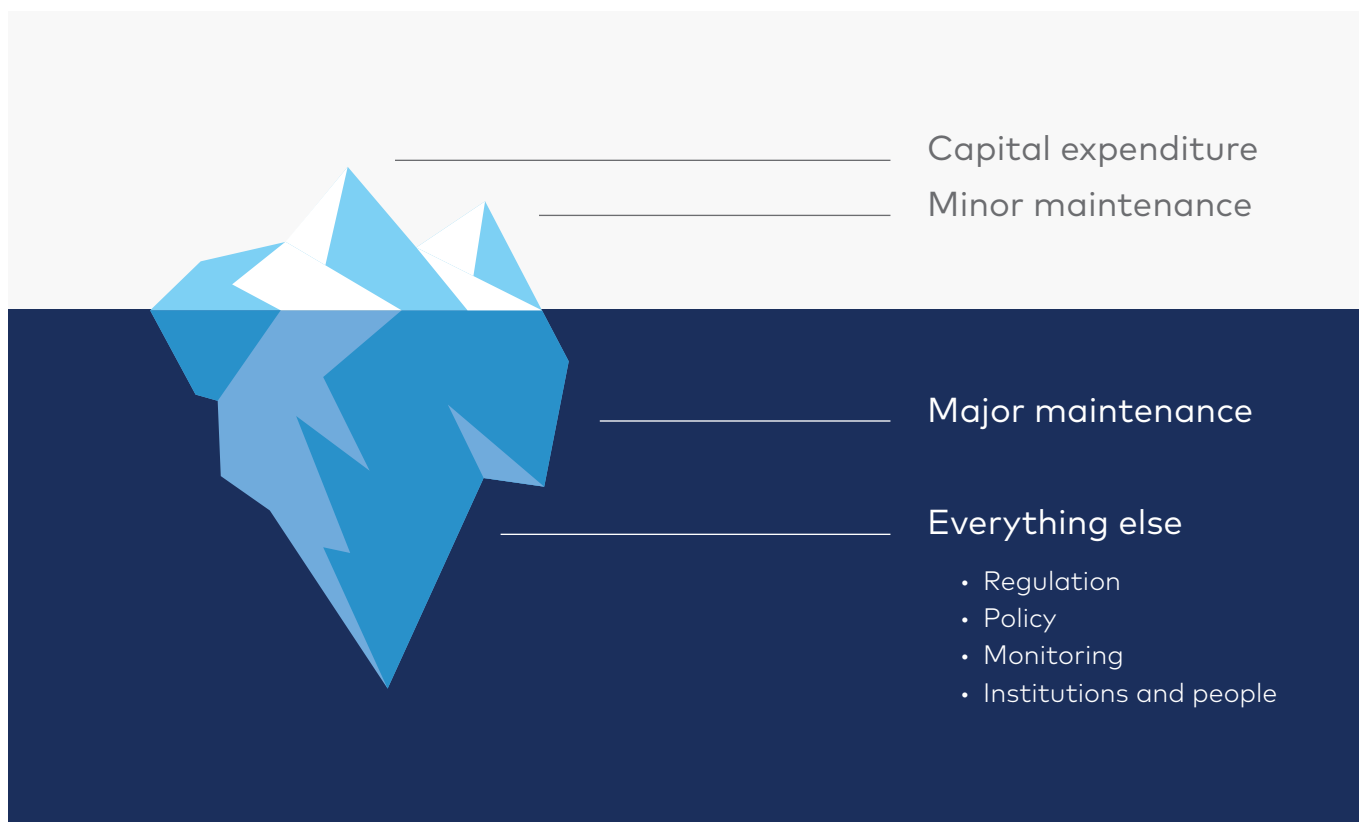
# Introduction

There is an inherent challenge facing the water, sanitation and hygiene (WASH) sector - sustainability of services for everyone. As of 2015, 660 million people still do not have access to improved drinking-water sources and over 2.4 billion people do not have access to improved sanitation<sup>1</sup>. This is due to "systems blindness" — a focus on the tangible infrastructure without attention to the supporting systems (Figure 1).

Globally, investments concentrate on the construction of infrastructure (capital expenditure) with insufficient attention on the systems needed to make the water and sanitation infrastructure function properly: regulations, policies, monitoring, institutions and the people that provide WASH services at regional, district and municipal levels. The lack of non-capital expenditure and support for service authorities, service providers and the necessary systems results in high rates of non-functionality, poor-services and stagnation in coverage. The sanitation sector is particularly off track to reach the SDG Goal 6 in many countries<sup>2</sup>.

To reach Goal 6 of the Sustainable Development Goals (SDGs), "ensure availability and sustainable management of water and sanitation for all", there is an urgent need to address the systems blindness and build strong institutions that are able to professionalise the water and sanitation sector and attract both public and private funding to reach universal coverage.

**Figure 1: Systems blindness to non-capital expenditure**



## Limitations: Taxes, Tariffs and Transfers

There are only three sources of financing for water and sanitation services: taxes, tariffs and transfers. Currently, the combination of these funding sources is not sufficient to address the need for water and sanitation services in developing countries.

**1. Tariffs** are consumer contributions for water and sanitation services. In most countries in the World, including the US and Europe, consumer tariffs cover minor maintenance as well as a part of major maintenance. However, tariffs rarely cover the full cost of major maintenance or replacement, nor do they pay for the staff in regional and district departments that are responsible to ensure that services are provided. In low-income areas and poor communities, tariffs would become unaffordable if they reflected all the costs of service provision<sup>3,4</sup>.

With tariffs in many lower income countries being set at levels inadequate to cover even minor maintenance, public funds available at the district level in rural areas usually only cover salaries, not maintenance. This often leads to millions of dollars wasted because of a failure to pay 20 dollars to repair a leak or to provide fuel for motorised pumps<sup>5</sup>.

In the most recent UN-Water Global Analysis and Assessment of Sanitation and Drinking Water (GLAAS) survey results, more than half of the 75 countries surveyed indicated that household tariffs are insufficient to recover operations and basic maintenance costs. The survey also revealed that nearly 20% of countries lacked any mechanism to cover the operational financial gaps leading to maintenance delays, infrastructure deterioration and increases in service downtime. This is extremely challenging considering 33% of countries indicated that two-thirds of their WASH financing was derived from household contributions<sup>6</sup>.

**2. Taxes** are domestic taxpayer contributions to the government. Taxation is how high-income countries have achieved universal access to water and sanitation<sup>7</sup>. A steady and robust tax revenue system at national and local level allows governments to receive loans, use them to improve and expand their services and repay the loans.

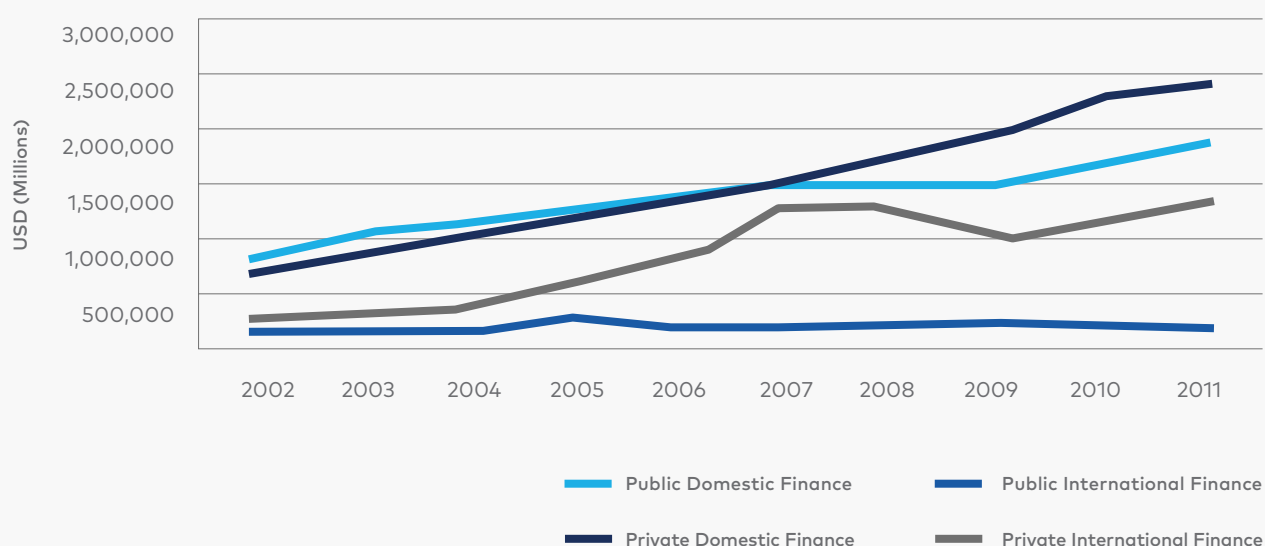
Available data on national budgets and expenditure from the GLAAS 2016/2017 survey indicates that government allocation and spending for WASH is increasing. However, more than 80% of countries report insufficient financing to meet national WASH targets or the higher levels of service outlined in Goal 6 of the SDGs<sup>8</sup>.

**3. Transfers** are funding provided by external aid agencies. From 2012 to 2015, external aid commitments for water and sanitation, as a portion of total aid commitments, have steadily declined from 6.2% to 3.8%. The hard numbers demonstrate this is a significant cut in aid contributions. Global aid commitments have decreased from 10.4 billion USD to 8.2 billion USD and from 3.8 billion USD to 1.7 billion USD in Sub-Saharan Africa<sup>9</sup>. Adopting more effective finance models, such as sector-wide approaches and multi-donor trust funds, has been slower for WASH than for other sectors, such as health and education<sup>10</sup>.

## Opportunities: Domestic Resource Mobilization

A key outcome of the Third Financing for Development Conference in Addis Ababa in 2015 was the recognition that sustainable service delivery for water and sanitation will rely primarily on domestic public resources and need to be supported by international cooperation<sup>11</sup>. To ensure universal access to basic social infrastructure, the intergovernmental agreements propose an increase in public spending to secure adequate investments. Sustainable and climate resilient infrastructure, on the other hand, will require both international private and public investments<sup>12</sup>.

**Figure 2: Development finance, all developing countries 2002-2011**



Source: United Nations. 2014. Report of the Intergovernmental Committee of Experts on Sustainable Development Financing. Report A/69/315

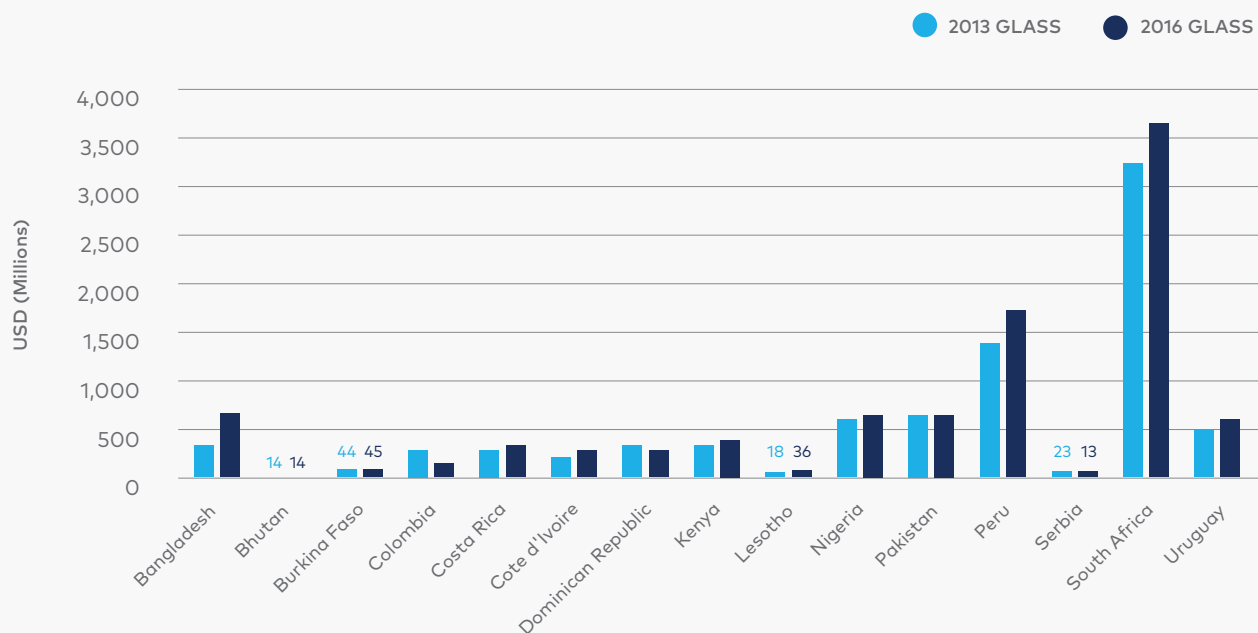
The trends point to clear opportunities, as domestic private and public finance in developing countries more than doubled between 2002 and 2011. This growth mainly reflects progress in middle-income countries. Domestic public finance also doubled in low-income countries, though it remains insufficient to meet sustainable development needs<sup>13</sup> (Figure 2). For the water and sanitation sector specifically, annual government water and sanitation budgets are increasing at an average rate of 4.5% higher than inflation<sup>14</sup> (Figure 3).

In this position paper we discuss three issues that address the limitations and build on the opportunities for increasing funds for the sector while reducing inequalities, namely:

- 1. The lack of finance for strengthening the enabling environment**
- 2. The untapped use of micro and blended finance**
- 3. The inequities in allocation of finance in the sector**

The paper provides concrete examples that highlight good practices and demonstrate how these important challenges are being addressed.

**Figure 3: Annual government water and sanitation budget allocation as reported to GLASS 2013 and 2016**



Source: FINANCING UNIVERSAL WATER, SANITATION AND HYGIENE UNDER THE SUSTAINABLE DEVELOPMENT GOALS. UN-Water Global Analysis and Assessment of Sanitation and Drinking-Water (GLAAS) 2017 report. Geneva: World Health Organization; 2017.

# Key Issue 1

## Lack of finance for strengthening the enabling environment

Investing in pumps, pipes and latrines alone is not sufficient to achieve universal access to safely-managed water and sanitation services. Governments need to invest in the systems (institutions and service providers) that support existing infrastructure in order to effectively provide services. Additional private finance is needed but requires the sector to be more attractive for investments including (government) guarantees that loans are repaid and/or a minimum return on investments.

The latest World Bank estimates indicate that achieving universal access to safely managed water and sanitation (SDG targets 6.1 and 6.2) would cost approximately 114 billion USD per year for capital expenditure – an amount that is three times the current investment levels. The costs for sustaining universal coverage and maintaining the infrastructure, a recurrent expenditure, will exceed the annual capital cost requirements by approximately 1.5 times<sup>15</sup>.

The above estimated infrastructure costs do not include climate resilient technologies or the costs to reach the more ambitious targets under Goal 6 which are relevant for middle and higher income countries. These include target 6.3 on improving water quality and halving the proportion of untreated wastewater; target 6.4 on increasing water efficiency; target 6.5 for implementing integrated water resources management; and target 6.6 to protect and restore water-related ecosystems<sup>16</sup>. If we take into account all targets under Goal 6, continued investment at the current levels will make achieving SDG 6 by 2030 nearly impossible.

As more capital infrastructure is constructed to meet the ambitious 2030 target of universal access, there will be increased maintenance costs for the recently-constructed as well as pre-existing, aging infrastructure. For maintenance investments to have their intended impact, the systems and institutions that are charged with operating them need to have adequate resources – human as well as technological.

Effective investment in local systems, or the enabling environment, includes direct support for rural water service providers to help them deliver, maintain, monitor, grow and improve water and sanitation services as well as indirect support for local, regional and national level planning and policy making, budgeting, regulation and discharge of other sector roles.

*Successful cases of organizing direct support were found in lower- and middle-income countries in Latin America and Southern Africa, where an expenditure of about 3 USD per person per year was related with effective rural water service provision. In other countries in Sub-Saharan Africa, where levels of expenditure on direct support were generally much lower than 1 USD per person per year, services provided were generally poor<sup>17</sup>.*

Investment in the enabling environment is harder to attract than infrastructure projects, in part because the outcomes are harder to see in short project timelines. However, evidence of stronger, more capable finance and water sector systems would give private financial institutions more confidence to invest in these countries and utilities.

A recent desk-review<sup>18</sup> of publicly-available information from 19 countries illustrates how difficult it currently is to mobilize private and public finance (domestic and international) for service providers in middle- and lower-middle income countries. A minimum of seven criteria will need to be in place for service providers to become more attractive for private and public finance. Four of the criteria are related to governance of the water, sanitation and hygiene sector, while the others are broader in scope and concern the countries' financial sector (Figure 4).

**Figure 4: Criteria to attract additional private and public finance to the WASH sector**



## WASH criteria

Having **clear institutional roles and a legal framework that defines asset ownership** is a major component of attracting private and public finance. If asset ownership is not legally defined, no large maintenance and rehabilitation can take place and no loans will be provided because there is a lack of a guarantee.

**Non-revenue water and cost-recovery ratios** are indicators of service provider performance and efficiency. They also indicate the amount of costs that are recovered by tariffs and, therefore, the amount of dependency service providers have on subsidies as well as their ability to repay loans. Data analyzed by Hutton and Varughese highlighted that 43% of 839 water and sanitation utilities did not fully recover their operating costs<sup>19</sup>. More than half of countries in the GLAAS survey indicated that tariff revenues to cover operation and basic maintenance costs were insufficient<sup>20</sup>. In many of the countries analyzed, the issues are not lack of capacity or financial management skills: legal ceilings for tariffs make it impossible to charge cost-reflective tariffs<sup>21</sup>.

**Benchmarking of service providers** by the regulator or service authority is an indication of the relative performance of service providers compared with each other which allows for triangulation and validation of the previous three criteria.

The final critical component is the **availability of a sufficient project pipeline by the service providers**. This demonstrates the readiness of utilities and service providers to improve or expand services once funding is made available. This information is only available in-country.

## Financial criteria

Without the **existence of domestic bank financing and other non-grant financing mechanisms**, it will take time and effort to develop sector-specific financial products. This is especially relevant in situations where grants effectively crowd out private finance. Once there is a benchmark of water utilities and service providers in place, the next step to enable private finance into the sector is to assess the **credit-worthiness of the utilities**. Finally, to access more sophisticated blended funds at the national level, the existence of a bond market and a government with the ability to issue bonds will also be a requirement.

## Analysis of criteria against benchmarks

Figure 5 summarizes the findings of the recent desk review of 19 countries and their ability to meet criteria deemed critical for attracting and securing private finance. Half of the countries did not meet the minimum criteria, including a sufficiently attractive credit rating for service providers and utilities; the existence of a bond market; or domestic bank financing for water and sanitation. The vast majority of countries do not meet the WASH sector-specific criteria, including clear institutional roles; a legal framework that defines asset ownership and sets requirements for non-revenue water ratios; adequate cost-recovery ratios; and active benchmarking of service providers.

**Figure 5: Summary enabling environment criteria for selected countries**

● Strong ● Moderate ● Weak

| Criteria                                              | Bangladesh | Benin    | Cambodia | Ethiopia | Ghana    | India    | Indonesia | Kenya    | Madagascar | Mali     |
|-------------------------------------------------------|------------|----------|----------|----------|----------|----------|-----------|----------|------------|----------|
| Institutional and legal framework                     | Weak       | Moderate | Strong   | Strong   | Strong   | Strong   | Moderate  | Moderate | Moderate   | Moderate |
| Non revenue water ratio                               | 26%        | 28%      | 7%       | 23%      | 52%      | 42%      | 30%       | 42%      | 34%        | 28%      |
| Cost recovery ratio                                   | 1.4        | 1.96     | 2.57     | 1.15     | 1.16     | 0.55     | 1.39      | 0.97     | ND         | 1.15     |
| Benchmarking of service providers                     | Weak       | Weak     | Strong   | Weak     | Moderate | Moderate | Moderate  | Strong   | Weak       | Weak     |
| Domestic bank financing / non-grant financing to WASH | Moderate   | Moderate | Strong   | Moderate | Moderate | Moderate | Strong    | Moderate | Moderate   | Strong   |
| Credit rating / worthiness of utilities               | Weak       | Weak     | Strong   | Weak     | Moderate | Strong   | Strong    | Strong   | Weak       | Weak     |
| Bond market                                           | Moderate   | Moderate | Strong   | Weak     | Strong   | Strong   | Strong    | Moderate | Weak       | Weak     |

| Criteria                                              | Malawi   | Mozambique | Nepal    | Philippines | Rwanda   | Senegal  | Tanzania | Uganda   | Zambia   |
|-------------------------------------------------------|----------|------------|----------|-------------|----------|----------|----------|----------|----------|
| Institutional and legal framework                     | Moderate | Moderate   | Moderate | Moderate    | Strong   | Strong   | Strong   | Strong   | Strong   |
| Non revenue water ratio                               | 33%      | 46%        | ND       | 43%         | 41%      | 33%      | 56%      | 35%      | 51%      |
| Cost recovery ratio                                   | 1.07     | 1.13       | ND       | 2.4         | .082     | 1.39     | 0.77     | 1.36     | 1.11     |
| Benchmarking of service providers                     | Moderate | Strong     | Weak     | Moderate    | Weak     | Strong   | Moderate | Strong   | Strong   |
| Domestic bank financing / non-grant financing to WASH | Moderate | Moderate   | Strong   | Strong      | Moderate | Strong   | Moderate | Moderate | Moderate |
| Credit rating / worthiness of utilities               | Weak     | Moderate   | Weak     | Moderate    | Weak     | Moderate | Weak     | Weak     | Moderate |
| Bond market                                           | Moderate | Weak       | Moderate | Strong      | Moderate | Strong   | Moderate | Strong   | Moderate |

Source: Fonseca et.al 2016. Strengthening the enabling environment for service providers. Unpublished report prepared for the Dutch Ministry of Foreign Affairs.

In identifying the systemic weaknesses, these criteria simultaneously highlight the areas per country that need further development. The establishment of the Kenya Pooled Water Fund (Box 1) highlights one approach that has been undertaken to overcome these identified challenges. Work can also be done directly with microfinance institutions and communities (Box 2).

### **Box 1: Learning from the Dutch water banks: the Kenya Pooled Water Fund**

The Kenya Pooled Water Fund (KPWF) is currently being established to provide water utilities access to capital market, long-tenure, and local-currency finance. The fund has been designed to assist water utilities to achieve the Kenya Constitutional Vision 2030 mandate of full access to safe water and sanitation for all by lending to the water utilities for building their drinking water and sanitation infrastructure projects.

A pooled water fund sources funding primarily from the domestic debt capital market through the issuance of bonds to domestic pension funds and other institutional investors. The bonds' risk profile is reduced through pooling water projects and could be further reduced if guarantees, soft loans or grants can be obtained. The annual debt service for the water utilities will be lower than commercial bank lending through the combination of long-tenure lending and credit enhancement.

The first scoping mission to look at the feasibility of a pooled water fund took place in Kenya in April 2015. There was wide interest and support to establish the fund in terms of the loan capital it offers to water utilities as well as finance for drinking water infrastructure through harnessing domestic capital markets. National and local government, water sector authorities, utilities, pension funds, banks, development partners, legal firms and investment advisors, expressed this interest and support.

The Netherlands Embassy in Kenya decided to financially support the project in late 2016. The first step was to prepare a business plan for the KPWF and develop a pipeline of bankable project proposals. With the business plan approved in November 2016, the KPWF is under preparation.

**Source:** Netherlands Water Partnership. 2016. Kenya Pooled Water Fund (KPWF)

Private investments are needed to achieve SDG 6. Investing public money in the systems needed to make the water and sanitation sector sufficiently attractive and safe for bankable projects and long term returns is worth the effort. Governments will always have to act as final risk guarantors of private investment, and strong national systems are necessary to allow and attract private investment for new capital and private provision of services. Supporting the enabling environment and service providers is absolutely critical for advancing coverage and service levels.

### **Box 2: Improving utility capacity and catalyzing private financing in rural and urban Indonesia: Water.org's utilities assistance initiatives**

Many utilities in low- and middle-income countries must make considerable investments in both technology and staff to be financially, operationally, and environmentally sustainable. For the past two years, Water.org has been implementing a program that works to achieve these goals in Indonesia, where the Ministry of Public Works and Ministry of National Development Planning has set a goal of 100% water coverage by 2019.

Community-level water and sanitation provision responsibility was assigned to community-based organizations (CBOs) established by the Government for rural areas. Contributions from central and local governments helped establish 4,937 water supply CBOs and 251 sanitation supply CBOs. However, there remains significant unmet demand for water services in rural areas.

The Government has struggled to launch a comprehensive program that supports CBOs to expand beyond the initial setup phase. Government data in 2015 suggested that as many as 73% of CBOs are not yet operating sustainably and few have been able to access commercial financing to expand service provision. As experienced by many utilities in low- and middle-income countries, local banks are unfamiliar with the sector and reluctant to lend to these CBOs. Capital is available in the market, but the banks' lack of familiarity with water and sanitation, coupled with CBO difficulty meeting bank lending requirements, limits the flow of funds from banks to CBOs.

Water.org launched a program focused upon strengthening and financing CBOs in late 2016. The three-pronged program consists of mapping CBOs, strengthening the capacity of the most promising ones, and assisting them to secure financing with the end-goal being newly-acquired skills that make participating CBOs more attractive to commercial financiers.

Once the strengthening component is completed, Water.org tackles financing from both sides of the equation: it assists strengthened CBOs in preparing and presenting loan applications to financial institutions while encouraging financial institutions to consider CBO investment opportunities.

To date, 137 CBOs have completed the capacity-strengthening phase of the process. Of those CBOs, seventeen have completed the entire process and have received loans from local microfinance institutions (MFIs). These loans have resulted in approximately 564 households connected to water services for the first time and approximately 5,988 households experiencing improved service delivery (increased hours of service and/or water pressure) and network expansion.

Source: Water.org. 2016. "Overview of CBO Strengthening and Financing Program"

## Key messages:

1. Investment in the enabling environment is required for:
  - Improved quality and sustainability of water supply and sanitation services
  - Attracting more finance to the sector by signaling to financial markets that water and sanitation investments provide a reasonable risk
2. When planning to meet SDG targets, finance ministers, line ministers and service providers should budget for the recurrent costs of maintaining existing services and should assume that these will be at least of similar magnitude to capital expenditure per year. The sources of the funding might vary, but these costs should be accounted for when preparing budgets and developing sustainable asset management plans at sub-national levels.
3. Investment in public resources, leveraging private money to fund capital investments, is an efficient and effective use of scarce government resources. This provides an opportunity to attract private funds and improve risk/reward profiles.

## Key Issue 2

### Untapped use of micro and blended finance

Governments must adopt new methods of financing to achieve the promise of universal, sustained water and sanitation for all. Financial innovations are needed and should draw upon a blend of multiple public and private sources.

Public finance and development aid alone will not be sufficient to achieve the ambitious targets of SDG 6. The sector requires significantly more funding to ensure that water and sanitation infrastructure investments are properly maintained and deliver quality services over time. Solutions that take a blended approach – strategically and intentionally combining aid, public and private finance – are emerging as an optimal approach to stretching limited public and aid resources.

Microfinance is one part of the solution: enable the poorest to take small loans so they have the up-front capital needed to pay for the water connection and/or toilet that they want. These clients then repay back these small loans with interest over time. Microfinance is one tool that can act as a catalyst for the private component of blended finance. It can also be effectively paired with government subsidies to accelerate water and sanitation access, as has been occurring in India since the roll-out of the Swachh Bharat Abhiyan, or Clean India Campaign<sup>22</sup>.

There is a large percentage of low-income households which could finance WASH improvements over time. However, WASH microfinance is neither intended to reach people living at the absolute bottom of the economic pyramid (ABOP) nor those facing high costs of obtaining access. Those populations will continue to need government support. If microfinance reduces pressure on governments to support those closer to the poverty line, public funding can be more effectively targeted to the ABOP. Barriers to scaling WASH microfinance are high levels of real and perceived risk incurred by financial institutions engaged in microfinance. Financial institutions incur high levels of risk due to lower-than-average collateral requirements and higher administrative costs. There are higher costs associated with managing multiple small loans as compared with fewer, larger loans, and creditworthiness assessments are harder to conduct with people who have little or no credit history.

Microfinance institutions prefer to offer loans classified as “productive” or “income-generating”. The lender has confidence that a client will be able to repay a loan if the loan is taken for the purpose of starting a small enterprise. There is less confidence in the repayment ability of a client who borrows for a “consumptive” purpose such as building a toilet, and for that reason microloans for water and sanitation are not common microcredit loan products. This occurs despite evidence that people repay water/sanitation loans at the same or higher rate than they do for other products<sup>23</sup>.

One method of overcoming hesitations to offer or take out WASH loans is outlined in Box 3. Another approach is to consider the income that is enabled when productive time no longer has to be utilized for collecting water or meeting daily sanitation needs. If taken into account, these gains in income would provide the same confidence in repayment that income-generating loans inspire. Viewing these loans as “income-enabling” rather than “consumptive” would encourage financial sector decision-makers to embrace these loans as a viable market opportunity rather than a risk<sup>24</sup>.

### Box 3: Revolving funds for water and sanitation

In Ghana, 49% of the rural population, almost six million people, lack access to any improved or shared sanitation facility. The north of Ghana is lagging even further behind. The open defecation rate in Nanumba South and North districts is 90%, posing serious health threats to the population. A significant challenge is related to finance. People have insufficient up-front cash to pay for latrine construction materials and are reluctant to take a loan and pay interest for an unproductive asset like a latrine. For this reason, revolving funds or credit schemes for latrines offered by local banks or MFIs often prove unsuccessful. Simavi and its local partner INTAGRAD developed an innovative loan structure: a loan of which one-third is meant for the construction of a latrine and the remaining two-thirds is meant for income-generating activities at an affordable interest rate.

This was tested in combination with Community-Led Total Sanitation (CLTS) capacity-building activities organized by INTAGRAD in 10 communities in Nanumba South District in the Northern Region of Ghana. To ensure funding was actually spent on latrine construction, the credit was disbursed in three tranches; the second tranche being released only after the latrine was built. To improve the financial viability of the loans, they were provided to community savings groups. This created a system of mutual guarantee among the members and diminished the risk for INTAGRAD.

The profit from the income generation activities allowed latrine loan repayment. Payback rates were as high as 98% over a period of 1.5 years. The credit scheme offered adequate sanitation to 1,400 people with a net investment of 1,200 USD.

Source: <https://rsr.akvo.org/en/project/4279/#report>

Governments can incentivize self-supply and the financial sector through regulations that support the uptake of water and sanitation microloans to achieve their universal access mandates. The Reserve Bank of India, for example, classified lending for water and sanitation as part of its Priority Sector Lending (PSL) category in 2015<sup>25</sup>. PSL designation is designed to accelerate economic development by encouraging investment in sectors that might otherwise not attract needed support. By broadening the PSL to include water and sanitation, the Reserve Bank of India is directly encouraging and enabling more people at the bottom of the economic pyramid to access household-level water and sanitation.

Other tools that blend public and private finance need to be explored to further assist governments to meet their SDG targets. As highlighted by UNICEF and the World Bank in their discussion paper in support of the Sanitation and Water for All (SWA) Finance Minister Meeting<sup>26</sup>, blended finance—the strategic use of public taxes, development grants and concessional loans to mobilize private capital flows to emerging and frontier markets—can leverage additional funds for the sector and reduce borrowing costs as compared to a fully commercial arrangement.

The multilateral development banks (MDBs) and the IMF are committed to “catalyzing, mobilizing and crowding in” private funds: leveraging their contributions to stimulate additional public and private funds<sup>27</sup>. Identifying effective ways to address risk is a major barrier to be overcome through new applications and updates to existing tools, including the establishment of mechanisms to provide guarantees, risk insurance, structuring pooled vehicles or co-investment platforms at national, regional or multilateral levels to reduce costs, and preparing grant funding for project preparation and execution.

Another avenue to be examined is integrating and mobilizing climate finance. While water currently occupies only a miniscule amount of resources from these funds, water transport, distribution, treatment and disposal – all components of "safely managed water and sanitation" – are energy intensive and figure into climate mitigation activities. Options for blended finance models are diverse, and many remain to be developed. The blended aspect of blended finance cannot be understated; private finance alone cannot meet the requirements for water and sanitation financing. Substantial targeted government investment will be required.

#### **Box 4: Water utilities in the Netherlands dedicate up to 1% of their turnover to international solidarity**

A motion inserted in January 2009 in the general law about water has allowed the Dutch water utilities to contribute up to 1% of their annual turnover, in cash and/or in technical assistance, to international activities that contribute to improving access to safe water and sanitation for the poor. It was agreed that this contribution should not lead to an increase in water tariffs in the Netherlands. In 2011, the Dutch water utilities spent approximately 0.5% in total, as they gradually expand their contribution towards the agreed maximum of 1%.

Most of this contribution is channeled through what are called Water Operator Partnerships (WOPs). The goal of WOPs are to promote not-for-profit partnerships and good practices between water operators, and between operators and any other interested party related to the water and sanitation sector. The relationship is typically for five to ten years, allowing for long-term knowledge exchange and relationship building, often internationally.

Source: Vitens Evides International and <http://www.water-1percent.org/en/join-platform>

### **Key messages:**

1. Governments should encourage their financial sectors to prioritize socially-oriented microloan products via regulations to enable larger proportions of low-income populations to access WASH. This allows governments more efficient use of their limited budgets.
2. Government policies and investment practices should facilitate investment from domestic and international investors and from private users themselves. Effective combinations of policies and practices can catalyze household, utility, and sector-level financing models that crowd-in private funding to increase coverage more quickly and sustain services over time.

## Key Issue 3

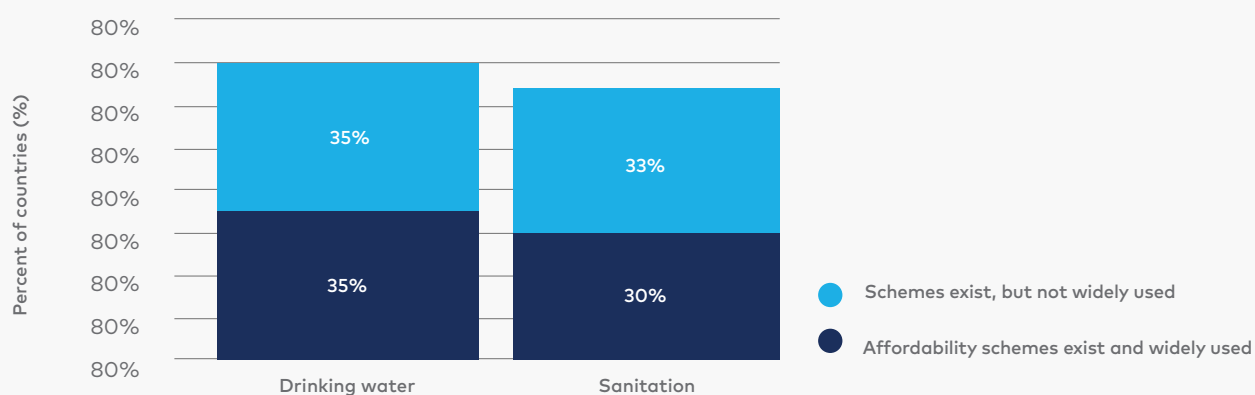
### Inequities in allocation of finance in the sector

Current investment in water and sanitation services is neither ensuring equitable coverage nor benefiting the people who most lack access to improved services.

In developed countries throughout the world, water and sanitation services for the poor have been dependent on public finance and redistributive domestic taxation and tariff systems. Inequality in WASH service investment and delivery has remained a persistent challenge. Many countries still face striking inequalities, driven by failure to equitably allocate funds to meet demand<sup>28</sup>. These pockets of inequality exist in both urban and rural areas. In many cities, piped water systems are poorly governed and unaffordable or inaccessible to low income populations. High connection fees (as a percent of income) often prevent the poor and disadvantaged from accessing the service while higher-income customers often receive their services at a subsidized rate. Residents of slums and informal settlements typically lack access to basic public services, due in part to physical space and land tenure constraints<sup>29</sup>.

The persistence of ineffective targeting means the poorest get left out of improved services. The 2015-2016 Sanitation and Water for All (SWA) update on commitments related to financing made by member-country governments reports that 16 countries have made very slow progress on their commitments to increase financial allocations to the sector. Half of the commitments related to eliminating inequities, focused on targeting resources and services at the people and areas that need them the most, have reported slow or no progress.

**Figure 6: Existence of financial schemes to make access to WASH more affordable to vulnerable groups**



Source: GLASS 2016/2017 country survey

In 2015, regions with higher numbers of people without access to improved sanitation or drinking-water from an improved source received only 48% of global Official Development Assistance (ODA)<sup>30</sup>. The GLAAS 2017 report indicates that over 70% of countries report having specific measures to reach poor populations in their WASH policies and plans. However, the implementation of such concrete measures is lagging: few countries indicate that they are able to consistently apply financing measures to target resources to poor populations.

For water, sanitation and hygiene investment to reach low-income, vulnerable populations, governments should not rely on external aid flows to meet those social goals. Instead, they need to look toward social policy and the potential redistribution of domestic public finance. In the GLAAS 2017 report, 60% of the seventy-five respondent countries indicate that affordability schemes exist for drinking-water and sanitation services; however, only half of these schemes are used. The schemes mostly heavily utilized by low- to higher-income countries<sup>31</sup> include:

- Government subsidies for infrastructure and operation and maintenance to support affordable tariffs
- Reduced tariffs for specific population groups
- Block tariff structures, with a highly subsidized first block (e.g. 0 to 7 cubic meters) to cover basic need.

The history of how developed countries achieved universal access to water and sanitation clearly indicates that domestic public finance has been and remains critically important even in strongly market-led economies. In all cases, government leadership and high-level political commitment has been a key driver toward universal coverage. Box 5 offers an example from India.

#### **Box 5: India: a national tax for sanitation**

In India, budget allocations for rural programmes under the Ministry of Drinking Water and Sanitation are expected to gradually increase over the next 5 years, largely due to increased budgetary allocations for sanitation. Since the launch of the Swachh Bharat Mission (SBM) in 2014 to make India Open Defecation Free (ODF) by 2019, the Ministry's allocations to rural sanitation increased five times over: from 414 million USD in 2014-2015 to 2 billion USD in 2016-2017<sup>33</sup>. However, the actual rural per capita expenditure from 2012-13 to 2015-16 has decreased slightly from 2.1 USD to 1.8 USD per person per year.

In November 2015, India introduced a national public funding mechanism for sanitation: the Swachh Bharat Cess. This is a 0.5% tax levied by the national government on all taxable services.

These funds go to the national government budget (Consolidated Fund of India), which can be utilized for financing and promoting Swachh Bharat initiatives, but do not go to the states, which are the responsible agencies for water and sanitation services. To date, there is little information on how much revenue has been collected and how the funds are going to be used. There is support within India for improving utilization and targeting these funds. A poll among 8,941 citizens indicated 31 percent support for these funds being used to ensure that public and private toilets built under the SBM remain functional.

The Indian government should be applauded for its leadership in the sanitation sector and for mobilizing these funds. However, substantial work remains not only to ensure that the funds make it to those that actually need them but also that this is achieved with the right degree of transparency.

Source: Andrea van der Kerk. 2017. Public Finance for Rural Drinking Water and Sanitation in India. Working Paper. IRC. The Netherlands. Forthcoming.

The private sector alone is neither equipped nor incentivized to achieve universal water and sanitation coverage. **However, private finance alongside public finance can play an important role in water and sanitation service delivery.**

Governments should invest more of their budgets in water supply and sanitation, and encourage more redistributive tax structures to reach the areas and populations most in need. One example of actions that can be taken is provided in Box 6. For this approach to be effective, the mechanisms for the transfer of revenues along the implementation chain from national to local governments must be improved. Budget transparency is critical at all stages along this chain to ensure equity and efficiency. The latest survey results from the Open Budget Initiative leaves significant room for improvement in many countries<sup>32</sup>.

#### **Box 6: BRAC WASH reaching 39.5 million people in Bangladesh**

Globally, there are extensive obstacles to making progress towards SDG achievement. BRAC, an NGO that is active in microfinance, identified the following barriers to their WASH microfinance program in Bangladesh:

- Lack of community participation in decision-making on WASH services
- Insufficient capacity on the part of service provider
- Insufficient attention paid to people's behaviours
- Lack of financial means for the poorest
- Lack of institutional recognition of the need to address and transform existing gender inequity and power relations
- Lack of active involvement of women in planning, implementing, and managing water and sanitation facilities
- Insufficient coordination between government institutions, private sector, NGOs, citizens and other sector stakeholders

In an attempt to address these obstacles, particularly the lack of financial means, BRAC created a grant scheme that enabled latrine construction and improvement. Working in collaboration with government departments in 250 sub-districts (upazilas) in Bangladesh, BRAC reached 39.4 million people with sanitation, hygiene education and water access.

In the 177 upazilas that were supported by the Embassy of the Kingdom of the Netherlands (EKN) and the Bill & Melinda Gates Foundation (BMGF), BRAC WASH supported 32.8 million people to achieve hygienic sanitation through grants and loans; mainly by creating awareness and promoting demand. More than 11 million households made their toilets hygienic by installing or repairing a water seal, while 10.6 million households installed a new latrine at their own expense. A further 5.4

million people in poor and ultra-poor families received a latrine through direct support (loans and grants) from BRAC WASH. The remainder were supported by government schemes, other NGOS or other BRAC programmes.

To reach the 5.4 million poor and ultra-poor families, BRAC WASH provided loans. More than 170,000 loans were provided to poor households for hygienic latrines, of which 99% have been repaid. In addition, 1,750 interest-free loans were provided to rural sanitation centre entrepreneurs, of which 100% have been repaid.

A household-level life cycle costing study found that without the grant for latrine construction, hygienic latrines would not be affordable for the ultra-poor since they would require them to spend almost 6% of their reported income (0.3 USD per person per day).

Source: BRAC. 2016. Water, sanitation and hygiene: Nine years of scale and innovation in Bangladesh. Programme Report 2006-2015 [http://www.ircwash.org/sites/default/files/brac\\_wash\\_programme\\_final\\_report\\_2006-2015.pdf](http://www.ircwash.org/sites/default/files/brac_wash_programme_final_report_2006-2015.pdf)

## Key messages:

1. In lower- and middle- income countries, public finance is an underutilized method for reaching the poor with water and sanitation services, despite the fact that this is the funding vehicle uniformly used across the developed world.
2. More resources and political will are required to track public spending flows to understand where they are going, who is benefitting and why some populations are not reached. To achieve SDG 6, this ability to track and monitor financial flows needs to inform public policy to ensure that public spending is efficiently directed and targeted toward sustainable water and sanitation services.
3. More redistributive tax and tariff systems, and aid that is targeted more strategically, are needed to reach the areas and populations most in need.

# Conclusion

The ambitious nature of SDG 6 pushes the global community to shift away from a business-as-usual approach towards universal access to sustainable service delivery. The WASH sector experience with the Millennium Development Goals (MDGs) revealed that sustainability of WASH services continues to be an issue, that pockets of inequitable service remain, and sector finance has not been mobilized and maximized. These new, ambitious targets call for a renewed focus on financing to ensure water and sanitation services last over time.

As governments and other stakeholders evaluate how to integrate these goals into national plans and targets, attention to three critical areas is vital for truly sustainable success: providing finance for strengthening the enabling environment; utilizing micro and blended finance strategies to their full potential, and resolving inequities in the allocation and distribution of financing to ensure the poorest and most marginalized communities are not left behind.

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Acknowledgments: Roel Blesgraaf, Maitreyi Das, Betsy Engebretson, Fiona Gore, Claire Lyons, Pim van der Male, Patrick Moriarty, Guy Norman, Heather Skilling, Stef Smits, Rich Thorsten, Sophie Trémolet, Frank van Weert and Elynn Walter

The views expressed in this paper are endorsed by the lead author organizations as well as the following organizations and consortiums: Wetlands International, Akvo.org, Water & Sanitation for the Urban Poor (WSUP), Public Finance for WASH, and Watershed

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