UN-HABITAT REPORT ON THE WATER AND SANITATION IN SECONDARY URBAN CENTRES: PAPER 1

Innovative Financing




Experiences with Secondary Urban Centres Water Supply and Sanitation Service Delivery

Rachel Cardone and
Catarina Fonseca

UN-HABITAT

UNITED NATIONS HUMAN SETTLEMENTS PROGRAMME

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United Nations Human Settlements Programme (UN-HABITAT)
P.O. Box 30030, GPO Nairobi 00100, Kenya
Tel: 254 20 7623 120
Fax: 254 20 7624 266/7 (Central Office)
E-mail: info @ unhabitat.org
Website: http://www.unhabitat.org

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1 Introduction

Secondary urban centres vary widely, both in terms of economic base and water service delivery models. Moreover, what constitutes a Secondary urban centres in one part of the world may be deemed to be something else somewhere else. For example, what might be regarded as Secondary urban centres in India and China might be considered to be small cities in Africa. This paper specifically deals with financing mechanisms for towns with populations between 2,000 and 50,000 people. Such towns represent a significant proportion of the population to be reached if the MDGs are to be met. This is exemplified in Africa and Asia where a third of their populations live in either large or Secondary urban centres,[1] and where for every large town (of 50,000 to 200,000) there are ten smaller ones (population 2,000-50,000). At a very basic level, population projections suggest that these areas' populations will likely double within 15-years, and then again in 30 years.[2]

Secondary urban centres tend to be located on the border between urban/rural or peri-urban/urban, and can serve a variety of purposes. They can become market centers for rural areas a few days a week, placing pressure on basic infrastructure for short periods of time; or they can be growing areas in their own right, due to in-migration of permanent settlers. In either case, the need for piped water, appropriate sanitation and drainage to support commercial and industrial growth, as well as meet residential demands, is present, and often not met. Water and sanitation service provision in Secondary urban centres tends toward a combination of public-private utilities and small-scale domestic providers that serve their customers through a variety of technologies: piped water, standpipes, hand pumps and or vendors/tankers. Because of their dynamics, planning for and managing basic water services, and including wastewater drainage, can be a considerable challenge.

In this environment, traditional sources of external finance (ODA grants and concessional sovereign loans) are often inadequate, even as they are often the only type of finance available. Secondary urban centres lack the scale of larger urban utilities, a feature which attracts both public and sometimes private investment (national and international); yet they are often too large to benefit from the community-based and micro-finance mechanisms that are often applied with success in rural areas. Given their scope, there are potentially significant economic development and poverty reduction impacts to be gained through sustainable access to safe water, sanitation programs, and effective drainage in these areas. Thus, financing water supply and sanitation services in Secondary urban centres demands creative thinking.

Secondary urban centres require capital investments for piped networks, which, if designed to meet demand growth projections, are unaffordable. By contrast, because of their existing characteristics and constraints in accessing finance, small-scale entrepreneurs provide limited services. Consumers in these areas are perceived (wrongly) as having low willingness and ability to pay, although they pay sometimes 20 times more per m3 to informal vendors than those served with piped water. The large lump sums and other red tape required for having a legal connection perpetuate the situation.[3] Others,

1 World Bank Town Water Report, 2005.
2 Pilgrim et al., 2004.
3 Franceys, 2005

unable to spend so much for water, revert to unsafe water supplies, increasing the risk of cholera and other outbreaks of water-borne disease. For example, during 2004, of the 30 outbreaks confirmed as cholera, 25 occurred in Africa including major outbreaks in Cameroon, Chad, Guinea, Mali, Niger, Senegal and Zambia.[4]

This paper reviews some of the creative ideas that have emerged to address the financial constraints to Secondary urban centres water and sanitation service delivery. The paper emphasizes domestic sources of finance for both hardware and software investments. These ideas involve a range of different stakeholders, including users, informal providers, utilities, governments, NGOs, domestic banks, and donors. The structure of the paper is as follows:

- **Section 2** presents an overview of current financing trends and the implication of traditional and innovative sources of finance for Secondary urban centres;
- **Section 3** appraises some of the constraints to finance, especially related to Secondary urban centres; and
- **Section 4** provides examples from Secondary urban centres in different regions, to illustrate how innovative finance can be used and applied;
- **Section 5** builds on the findings from the previous sections to present preliminary findings. It should be noted that while there are many examples where innovative mechanisms have been used, substantial research that consolidates the range of experience is unavailable, leaving many questions unavailable. Hence, this section also presents suggested topics for further research.

The paper concludes with a **Glossary** of finance/water sector terms and **References** for further reading.

4 WHO, 2005

2 Finance trends and innovative financing (the supply side)

2.1 From the Camdessus report to innovative financing

Over the past few years, several studies and processes[5] have been conducted at different levels to quantify the financing gap for water sector investments needed to achieve international development targets. While there does not seem to be an agreement on the financial gap (between 2000-2004, nine key agencies produced different estimates with different assumptions[6]), there is agreement on the key constraints for water sector financing to be more effective. Box 1 provides an overview.

Since the launch of the Camdessus report at the Third World Water Forum in Kyoto (2003), a range of trends in financing have emerged:

- Greater attention has been paid to the role local capital markets can play in emerging and developing countries where governance frameworks are capable of supporting them. In countries lacking strong governance frameworks, initiatives and programs to address these weaknesses are underway. For example, the International Finance Corporation's (IFC) Municipal Fund[7] provides capital investments to municipalities and other sub-sovereign entities, without requiring a guarantee from the central government. The objective for this approach is to strengthen the ability to deliver infrastructure services at a sub-sovereign level. The project complements IFC's other project development facilities, which also provide technical assistance to small-scale enterprise, domestic banking institutions, and governing bodies at both sovereign and sub-sovereign levels.

- A number of programs and initiatives are focusing on the possibilities for more domestic-based financing options, including small-scale private service providers for water supply and sanitation; scaling up micro-finance initiatives to support water and sanitation schemes; and developing and implementing schemes that use grant financing in creative ways to generate sustainable, positive outcomes. For example, in 2005, DFID announced 20 GBP (US$36) million in funding to the Water and Sanitation Program for a Domestic Private Sector Participation Initiative (DPSPI),[8] to address the untapped potential, in management, operations, and finance, of the domestic private sector for the benefit of water and sanitation services in poor countries. This amounts to 12 GBP (US$21.6) million to Sub-Saharan Africa, and 8 GBP (US$14.4) million for Asia.

5 Including the World Panel on Water Infrastructure Finance, the EU Water Initiative Finance Working Group, and the UN Millennium Task Force on Water Supply and Sanitation.
6 Fonseca and Cardone, 2004
7 http://www.ifc.org/municipalfund
8 BNWP, 2005

Box 1 Findings from the World Panel on Financing Water Infrastructure (Camdessus report)

In 2003, the Camdessus report outlined the following conclusions about water sector finance:

- That the financial flows to the water sector are inadequate to achieve the MDG target of halving the proportion of people lacking safe water and sanitation;
- That government policies for the water sector should be decentralised to the lowest appropriate level, while decentralised sector institutions require substantial amounts of capacity to improve sector planning and management;
- That sustainable cost recovery principles need to improve, both in terms of increasing service providers' revenue generation, and in terms of institutional blockages to financial transfers (e.g. from governments and donors);
- That NGOs and local private sector operators have a strong role to play in developing the sector;
- That a reformed sector with improved institutional structures and governance will attract additional ODA as well as private capital; and
- That sovereign risk poses a strong disincentive for international investments, given their low returns.
- The report offers a range of proposals to move forward; these can be categorized as follows:
- Sovereign-level reforms, such that each country has a national water policy incorporating milestones to achieve the MDGs;
- Sub-sovereign level reforms, such that municipalities and water authorities gain greater responsibility, and capacity, to implement water policies and frameworks; and
- Local capital market development, such that local financing, from the public and private sectors can be used to support appropriate water and sanitation interventions.

Source: Winpenny, 2003.

- There is increased support for financing and project development facilities to stimulate a project pipeline and address different types of risk for public and private infrastructure investment. These facilities aim to strengthen project development and due diligence skills within a country, as well as design new approaches to use grants, debt, equity, and guarantees