

6TH W O R L D W A T E R F O R U M

Sustainable cost recovery: A shared responsibility

The Special Challenges of Sanitation

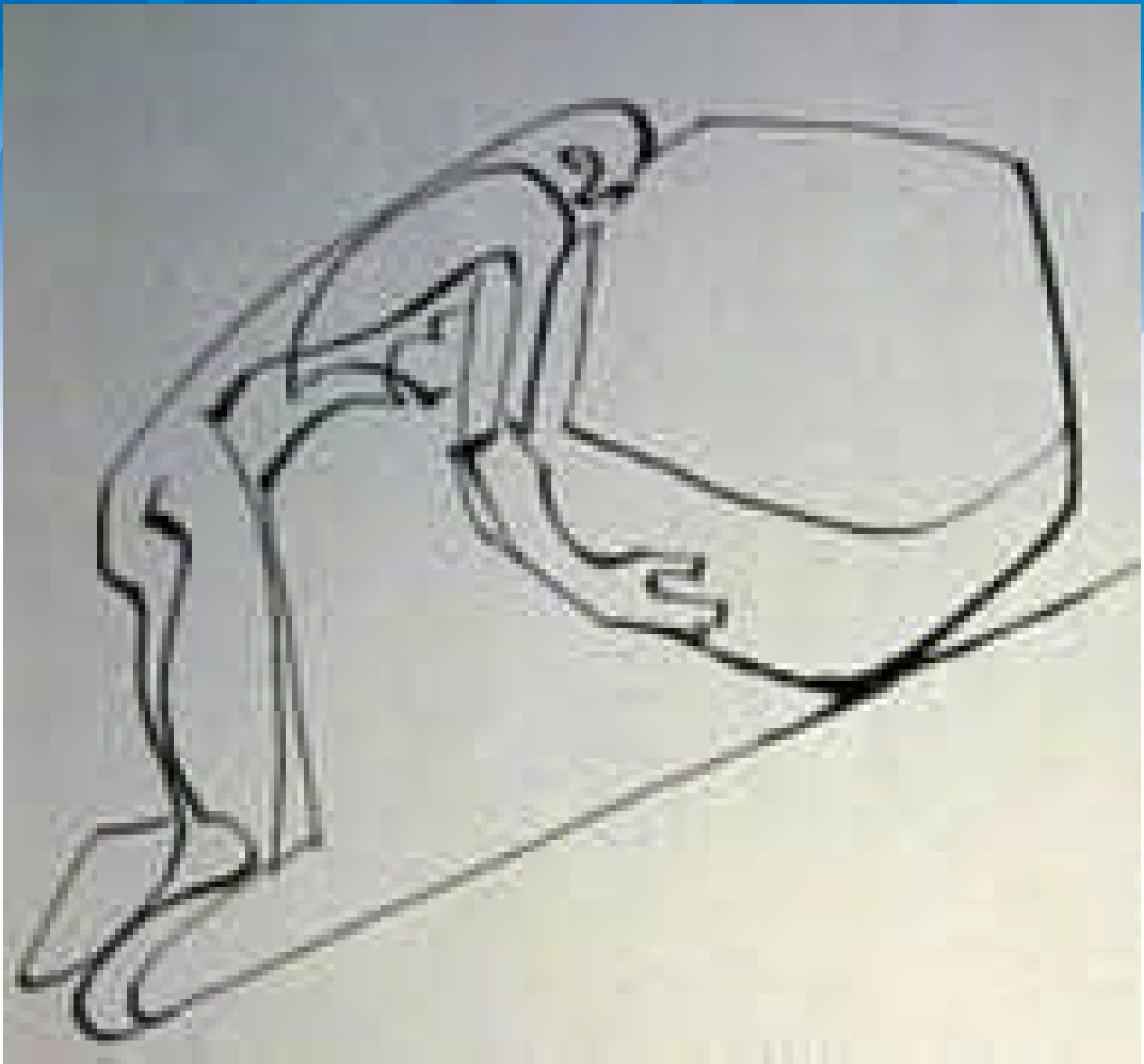


MARSEILLE, FRANCE '12

TIME FOR **SOLUTIONS**

Monica Scatasta
Deputy Economic Advisor
European Investment Bank
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MED 4.2 –Sustainable Financing
of Sanitation



The Challenge :

Financing inclusive AND sustainable services

🔥 Services – MDGs focus on access BUT quality of service is declining

- 🔥 Services that are inclusive **AND** sustainable (good service quality, long-lived) also require funding to **maintain** infrastructure
- 🔥 Over time : need to fund increased service level and asset replacement

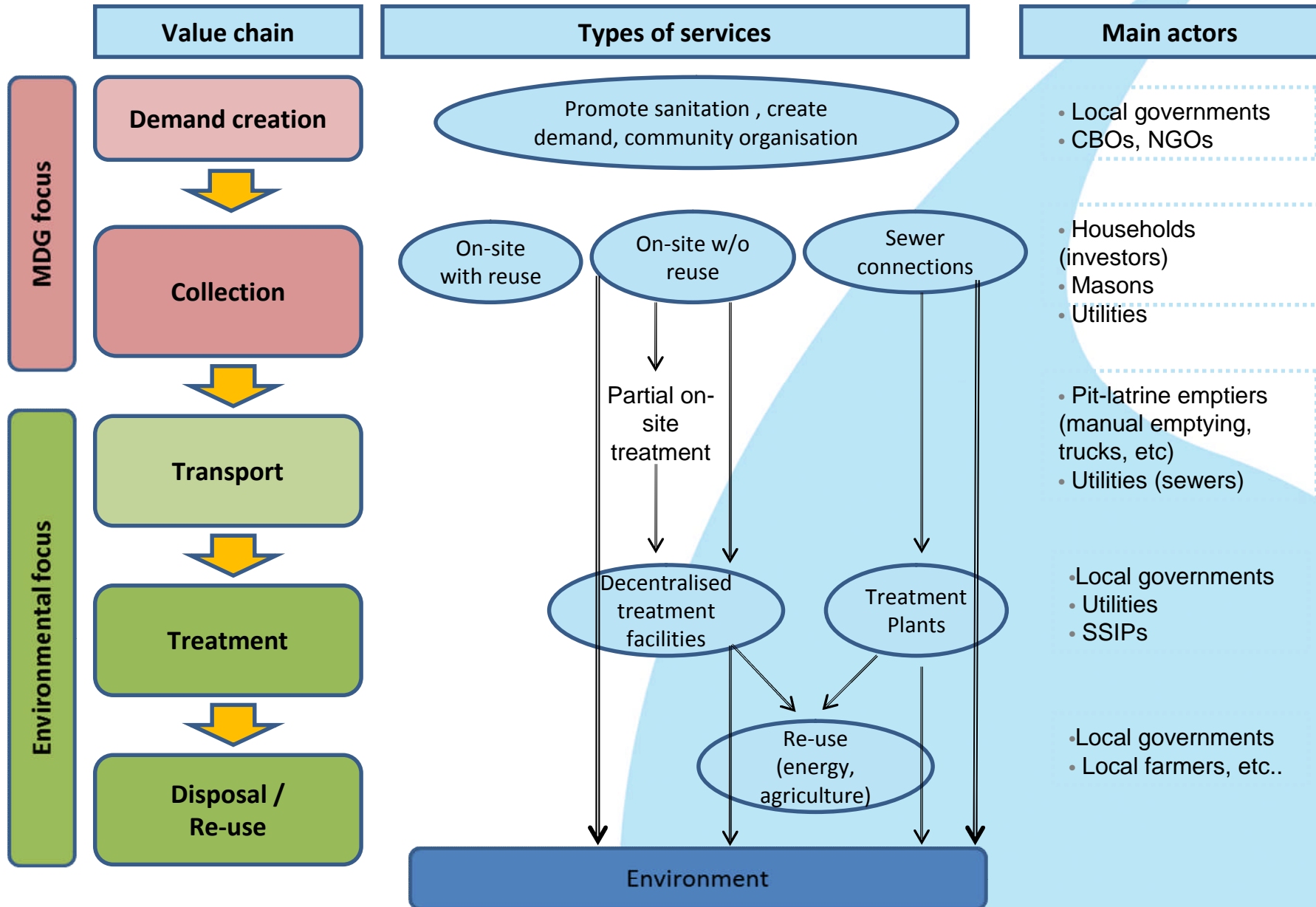
🔥 Resources – Need to protect, manage and secure access

- 🔥 Competition for water resources: efficiency, WDM alone won't suffice
- 🔥 Expanding urban areas menace local water sources → can society afford “free sewerage”?
- 🔥 And who will pay for adaptation to climate change?

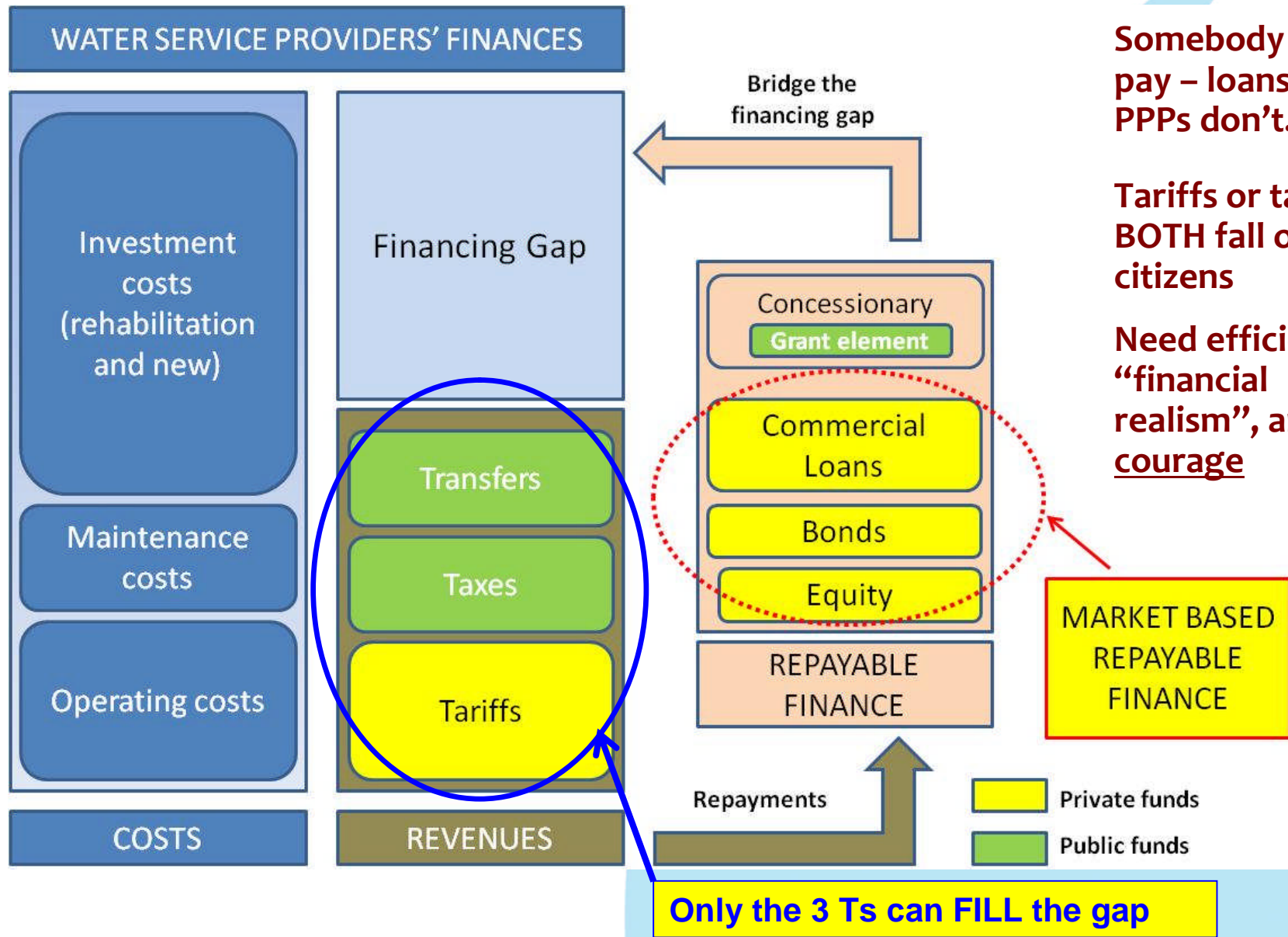
🔥 Sustainable Cost Recovery – The sobering reality

- 🔥 Revenues do not cover recurrent costs → Vicious cycle
- 🔥 Extension to lower-income area may be discouraged – although the poor pay much more today...
- 🔥 Little funding for resilience of infrastructure and protection of resources

Urban sanitation systems



No manna from heaven: Who really pays and how we can all pay less



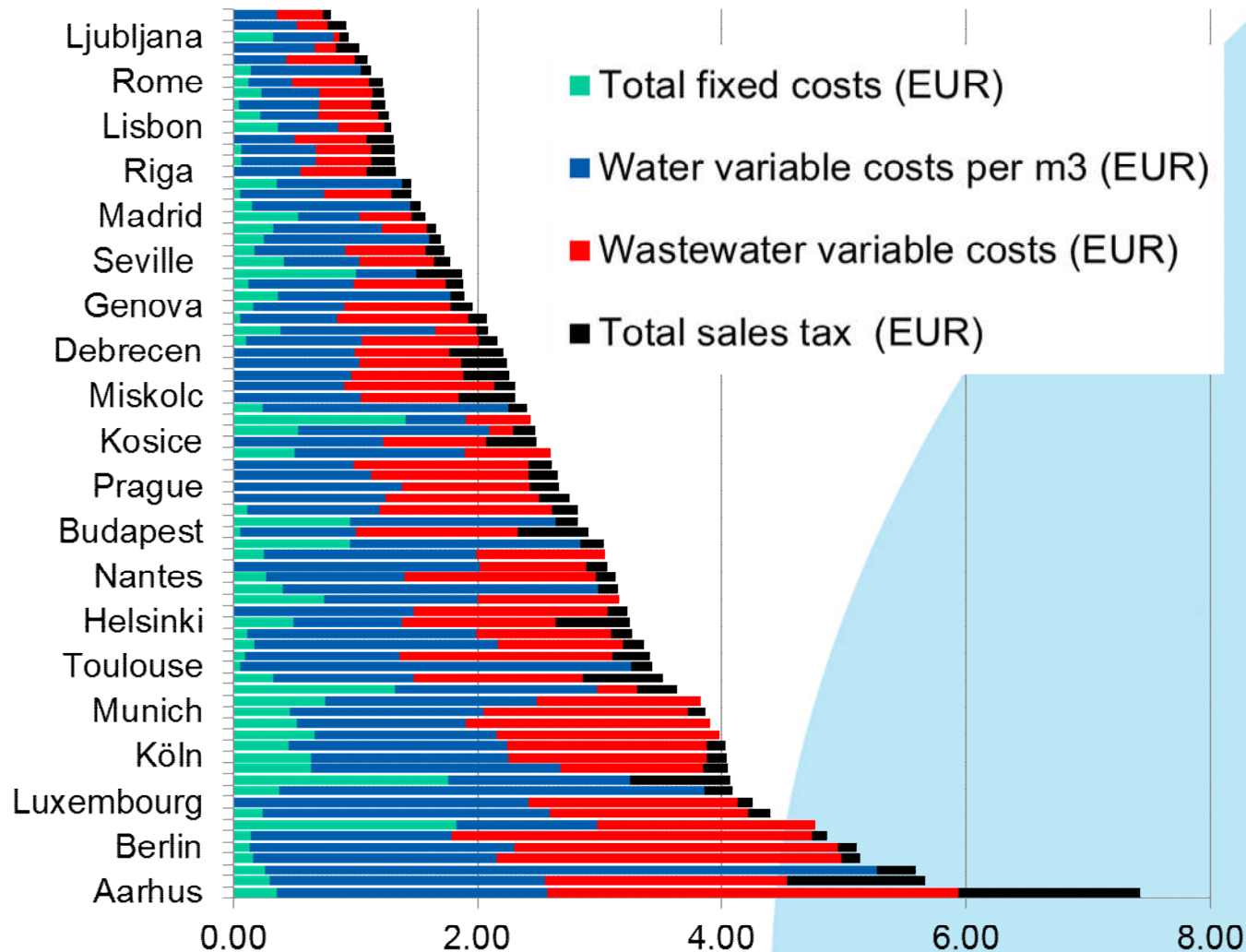
Somebody has to pay – loans and PPPs don't..

Tariffs or taxes? BOTH fall on citizens

Need efficiency, “financial realism”, and courage

Tariffs in practice – Examples from Europe

2011 Consumer Tariffs (EUR/m³)



Average Tariff

2.6 EUR/m³

**Wastewater
~50% of charges**

**Average Taxes
9% of bill**

**Dublin: no
charges**

**UK: mainly
unmetered**

**Investment
Subsidies:
0 to 100%**

Source: GWI, EIB

Sustainable cost recovery: A definition

☞ Appropriate mix of tariffs, taxes and transfers (OECD 3 Ts):

- ☞ to finance capital and recurrent costs in the long run, and
- ☞ leverage other forms of finance (equity, loans, bonds)

☞ Tariff policies that :

- ☞ are affordable to all users, including the poorest
- ☞ ensure the financial sustainability of service providers
- ☞ provide appropriate incentives (consumption, efficiency)

☞ Subsidy policies that :

- ☞ are predictable and reliable to facilitate investment planning
- ☞ meet social and environmental objectives (targeted, non-distortive)
- ☞ are affordable for national/local governments

SCR not just about full recovery from tariffs – but it is not a “blank check”..

The 3 T's are not perfect substitutes

☪ Different economic incentives for final users:

- ☪ Subsidies may lead to over-consumption and resource degradation
- ☪ Tariffs signal the value of water resources and services → *but is this always good for the environment, the people, the service provider?*

☪ Different managerial incentives for service providers:

- ☪ Power to the customer through tariffs? Demand efficiency, accountability
- ☪ Subsidies may lead to over-investment, reduce operational efficiency
- ☪ Subsidies may slow extension of access unless they are well targeted

☪ Different financial incentives for investors who prefer:

- ☪ Revenue streams that are sufficient and stable
- ☪ Revenues controlled by those who face the costs – but regulated!

***Important to choose the right “3T MIX”
→ but first must understand multiple policy objectives***

SCR components: Beyond numbers...

🔥 *A SCR strategy is composed of 3 elements :*

- 🔥 A complete tariff strategy (see below)
- 🔥 Reliable, predictable allocations from national or local budgets
- 🔥 Access to predictable, targeted grants from abroad

🔥 *A complete tariff strategy is composed of 3 policy tools :*

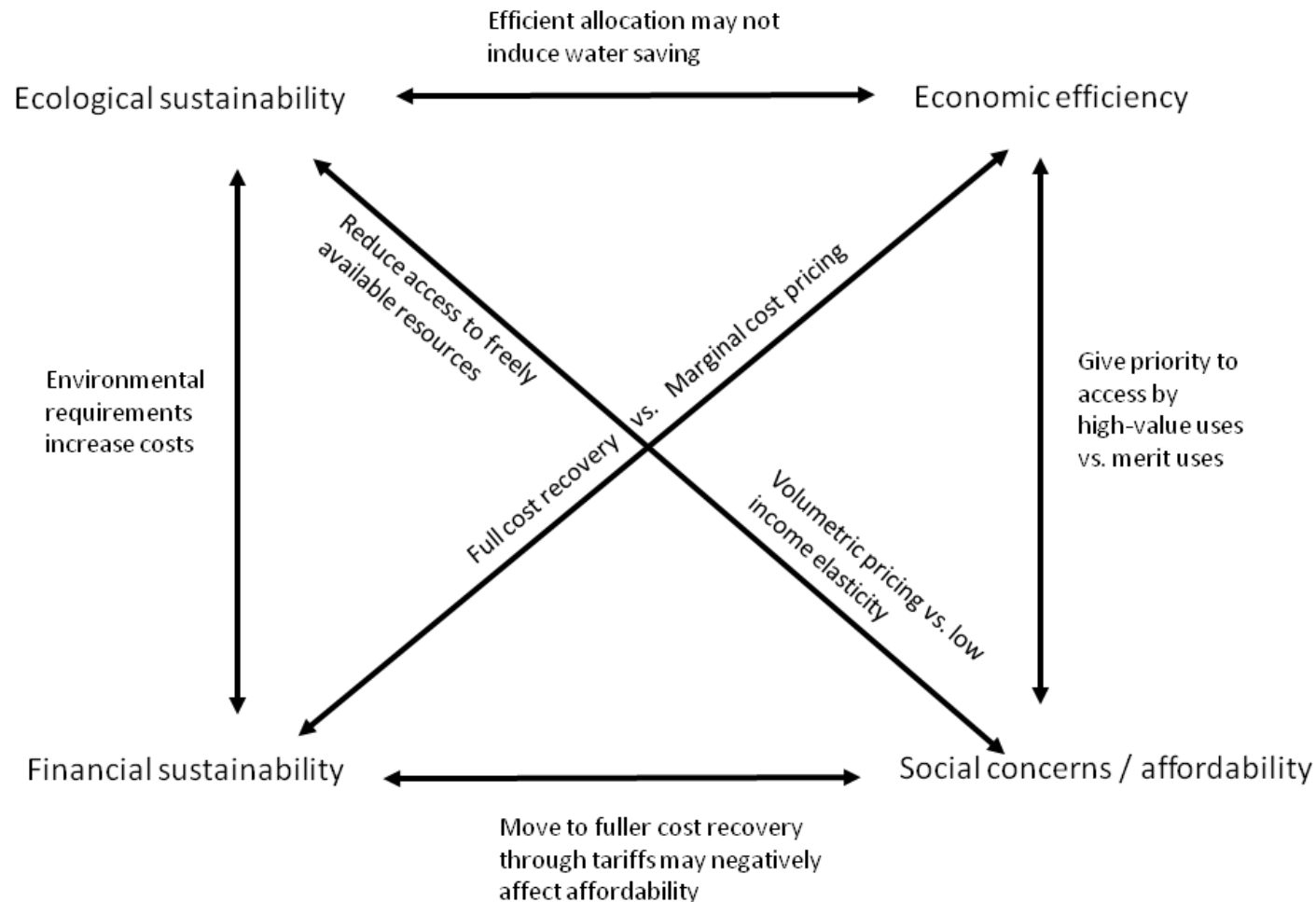
- 🔥 **Average tariff level** - a tool for financial sustainability, not for social concerns - keeping average tariff low harms the unserved
- 🔥 **Tariff structure** - a tool to address social and environmental concerns - but better coupled with non-tariff tools
- 🔥 A process and methodology for **tariff-setting and adjustment**

🔥 *Process matters :*

- 🔥 Rigorous measurement of affordability to target support
- 🔥 Clear tariff formulas to increase “political sustainability”
- 🔥 Citizens’ participation can help identify and implement solutions

SCR is about choosing a mix of instruments based on your policy goals and “political space”

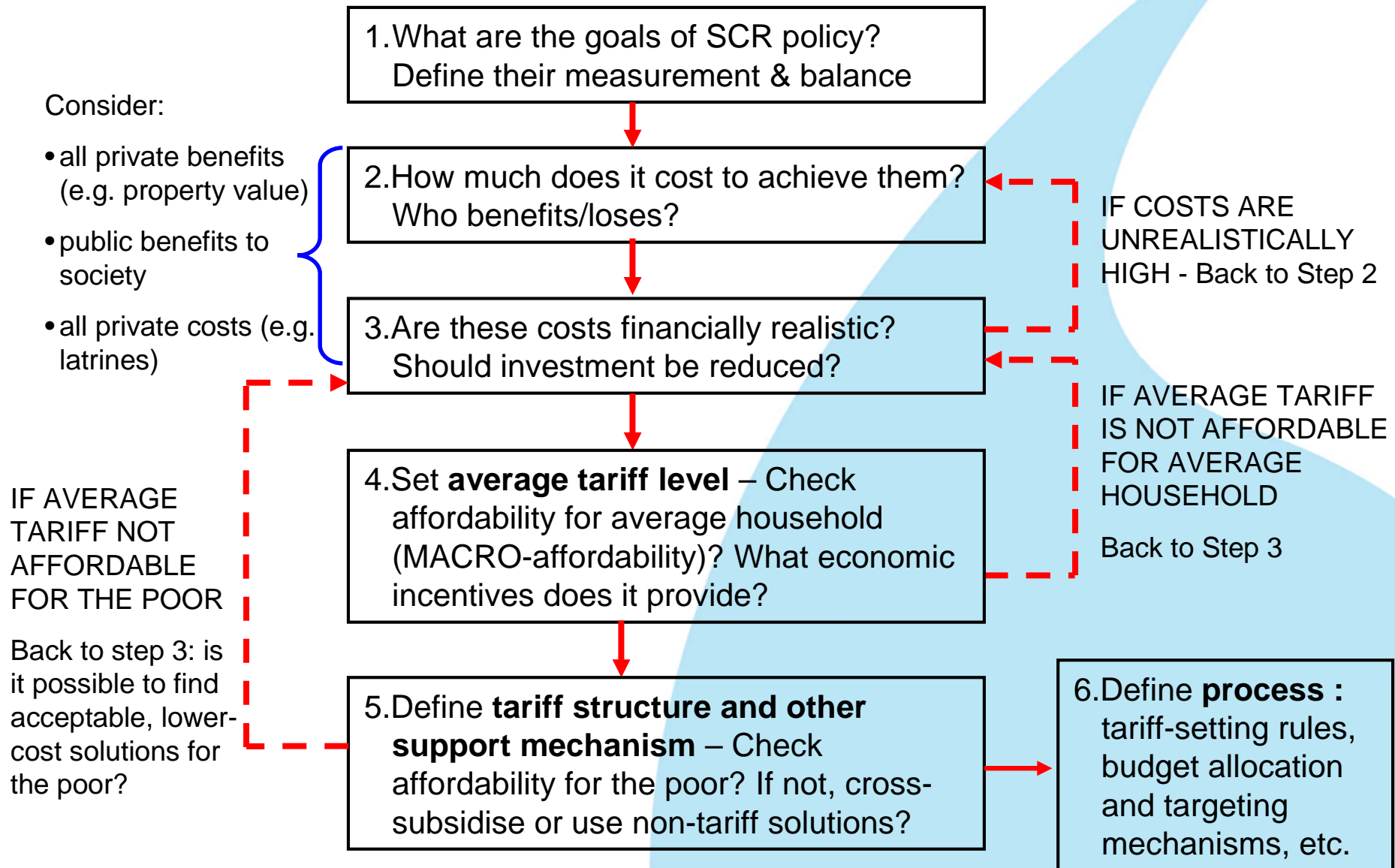
SCR, policy objectives & political choices



Source: OECD

- **Cannot achieve ALL goals – society needs to choose the balance**
- **But CAN find solutions if understand tradeoffs between goals**

Designing a SCR strategy – Choosing the “MIX”: A structured approach to decision making



The Special Challenges of Pricing Sanitation

- ***Users are generally less inclined to pay, particularly for wastewater treatment vs. drinking water***
- ***But investments requirements are often larger***
- ***Part of the benefits of sanitation are at the community, regional or national level***
- ***Rationale to for new cost allocation mechanisms:***
 - ***Costs can be shared with broader group of beneficiaries***
 - ***Subsidies can be justified for merit and public goods***
- ***But willingness to pay may be higher than anticipated... So ask the concerned people!***

Who should pay for services that provide benefits to communities beyond the direct users?

Affordability: Getting it right

- 🔥 **For average tariff levels (Step 4) : check the affordability of the average bill for average household → 4 options :**
 - 🔥 Increase revenue collection (should always be the first option)
 - 🔥 Reduce underlying costs – revise investment plans
 - 🔥 Cross-subsidize households from non-domestic users or charges on beneficiaries outside the area
 - 🔥 Increase revenue from other Ts – revise the target tariff level
- 🔥 **To determine tariff structures what matters is affordability for vulnerable groups → first need to define :**
 - 🔥 Which population groups are “poor” or “vulnerable”
 - 🔥 What is the acceptable “affordability threshold” for them
- 🔥 **If average bill is not affordable for the poor :**
 - 🔥 Reduce costs of services provided to the poor – only if acceptable
 - 🔥 Tariff structure with cross-subsidization from other customers
 - 🔥 Subsidize access rather than consumptions BUT support poor households through non-tariff schemes

Making it all happen: A shared responsibility

- 🔥 **Policy-makers – Stable rules, clear responsibilities, realistic goals and coherent SCR strategy → They control :**
 - 🔹 Directly tariffs and tax-based subsidies
 - 🔹 Indirectly grant predictability & effectiveness via donor dialogue
- 🔥 **Service Providers – Improved planning, efficiency, skills :**
 - 🔹 Develop investment pipelines that systematically consider wider sustainability issues and involve relevant stakeholders
 - 🔹 Improve implementation capacity, operational efficiency, commercial management / financial discipline
 - 🔹 Strengthen dialogue with: (i) policy-makers to justify subsidies and tariff increases, (ii) clients on service quality and acceptable tariffs
- 🔥 **FIs – Stable, targeted grants. Improved support for SCR:**
 - 🔹 Reduce erratic nature of grant funding but target them as\
 - 🔹 Adapt to evolving reality (e.g. decentralised solutions, small-scale providers)
 - 🔹 Support structured approach to financial sustainability
- 🔥 **Citizens: Call for service quality, efficiency, accountability**

Key Messages

- ☪ *There can be no effective right to water without SCR*
- ☪ *The “3T MIX” matters : 3 Ts are not perfect substitutes*
- ☪ *Assess affordability locally. Focus on affordability for the poor*
- ☪ *If average tariff level too low, this harms the unconnected poor*
- ☪ *Subsidies: Target the right people, avoid distortions*
- ☪ *Sanitation: Can we identify new sources of revenue? Are coverage and service level requirement financially realistic?*
- ☪ *Achieving SCR is a shared responsibility – in particular: Financial sustainability is largely a political choice and process matters (Rules, responsibilities for tariff-setting tariff and updating)*



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