UN-HABITAT REPORT ON THE WATER SECTOR IN SMALL URBAN CENTRES: PAPER 2

# Water Sector in Small Urban Centres

## Analysis of donor flows to water supply and sanitation services

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# 1 Introduction

This paper presents an analysis of Official Development Assistance (ODA) flows to the water and sanitation sector, based on data gathered from the OECD Development Assistance Committee (DAC) and Creditor Reporting Systems (CRS) databases, as well as current knowledge in the sector. As part of this analysis, ODA flows to the health and education sectors, as well as to broader topics including governance and finance, are also considered. Where possible, policy implications and specific discussion about small towns is provided, however there is a general lack of information about financing flows to small towns, due to the nature of the accounting systems used by donors (and reported to the OECD).

Historically, donors have used ODA to provide the majority of funding for water supply and sanitation activities in developing countries. They have done so through individual, ad-hoc, and sometimes competing programs, or through support to governments and other implementing agencies (such as I/NGOs). The growing acceptance of the Poverty Reduction Strategy Paper (PRSP) in recent years has created an opportunity for more coordinated development assistance as well as targeted poverty reduction in a way that reflects the demands and needs of countries. Current estimates to achieve the Millennium Development Goals (MDGs) for water and sanitation range from US$7.5 billion to US$70 billion annually[1], compared with the US$2-3 billion annually committed through ODA. Tracking donor flows, then, becomes all the more important, first to understand whether political commitments are consistent with funding decisions, and also to prime advocacy efforts for increased ODA, as well as analysis on the value for money created by ODA flows to the water and sanitation sector.

For example, in the water sector, the MDGs call for halving the proportion of people lacking sustainable access to safe water and basic sanitation has not translated into greater funding for the sector through traditional ODA financing sources (grants and loans). With Poverty Reduction Strategy Credits (PRSCs) driving national poverty alleviation strategies in most developing countries (PRSPs), how well a sector is profiled contributes to how the sector is prioritized, however even if a sector is prioritized, it does not always mean it would attract financing through the government budget.[2] This lack of attention suggests that the existing water sector finance and governance systems need to evolve – both to adapt to the current environment, and to create a new environment where the water and sanitation sector can attract the resources required to yield the economic and poverty reduction benefits so often attributed to it.

ODA to the water sector has typically been used to support infrastructure capital costs, and, as the data will illustrate, flows to the water sector continue to be biased towards larger infrastructure systems. Indeed, even the estimates costed at a global level to achieve the MDGs for water supply and sanitation tend to be based on initial construction costs.[3] However, the social and environmental benefits of these investments tend to be short-lived, because core principles of operations and maintenance, cost recovery to fund recurring and rehabilitation costs, and planning to meet present and future demand, are often overlooked. Because these principles require long-term investments in capacity building,

1 Fonseca, Catarina and Rachel Cardone, 2004.
2 WSP-Africa PRSP Benchmarking Review
3 Fonseca, Catarina and Rachel Cardone, 2004.

governance, business development skills, and the like, they tend not to attract traditional forms of donor finance.

While there is evidence of ODA flows supporting small utilities in small towns, the constraints to traditional ODA, outlined above, can be amplified. Other financing options are limited: while larger urban centers can assume loans (whether from the public or private sectors) for investments, and rural areas typically benefit from fully grant-based support, small towns fall into a 'middle ground'. Whether they serve as centers for rural markets that stimulate the establishment of a permanent population, or they are situated on the outskirts of larger urban areas, some of the challenges facing small towns regarding investments in water and sanitation include appropriate design of systems, sequencing of development, timing, and importantly, access to finance. The availability of branch banks in small towns that can provide products to domestic entrepreneurs is limited, due to a lack of capacity on the part of the banking sector. Opportunities for attracting finance through the national government may also be limited, particularly if the small town is not a municipality in its own right (a municipality may be responsible for several small towns, or a mixture of small town: rural, or small town: urban areas).

As key financiers for the water sector, donors have an important role in shaping sustainable water development, whether in urban, peri-urban, small town, or rural areas. To understand the recent history of ODA, this paper will consider ODA flows to the water and sanitation sector, looking at overall flows at a global and then regional level; this will be done by type of mechanism (grant/loan), and by comparing commitments with disbursements. It will then consider targeting of ODA flows, by sub-sector, to small towns, and to the poor, based on access data provided by the Joint Monitoring Program. To compare ODA flows to water relative to other expenditures, this analysis will track ODA flows to water supply and sanitation relative to health and education, by region and by income group (e.g. least developed countries, lower middle income countries, other low income countries, and upper middle income countries). To understand ODA flows to water supply and sanitation in relation to broader governance and economic development processes, such as the PRSPs, an assessment of ODA flows to governance and civil society, banking and finance, and business development is also provided.

**The structure of this paper is as follows:**

- **Section 2** outlines the OECD DAC and CRS databases, including their benefits and constraints.
- **Section 3** presents an analysis of ODA flows, using data from the DAC and CRS databases.
- **Section 4** provides some preliminary findings, as they relate in general to ODA, and more specifically for small towns.

This paper is complemented by another paper on *"Experiences in Innovation: Financing Small Town Water Supply and Sanitation Service Delivery"* which explores some of the innovative ways in which finance can be used to support and strengthen water sector development.

# 2 Overview of ODA flows to the water sector

## 2.1 Overview of the DAC

The OECD's Development Assistance Committee (DAC)[4] compiles statistics on development activities from OECD countries to developing countries. Data on the purpose of aid flows are gathered as commitments, which reflect project agreements, based on a calendar year. Donors report the face value of the activity at the date a grant or loan agreement is signed with a recipient, regardless of when disbursements are expected. Data on disbursements are also collected to monitor the implementation of activities. The OECD has two databases: the DAC, which provides aggregated information, and the Creditor Reporting Systems (CRS), which provides disaggregated details.

DAC statistics cover bilateral and multi-lateral aid to water supply and sanitation (Box 1 provides the details on what activities are covered by the water and sanitation category). For DAC countries, data on total aid commitments is available as of 1973, and is estimated to cover 85-90% of DAC countries' bilateral ODA for the water sector between 1990-1995, whereas from 1996 to the present, the data sets are close to complete. By contrast, information about disbursements has become more precise only in recent years.[5]

**Box 1 OECD DAC Definition of water supply and sanitation**

The DAC defines aid to water supply and sanitation as including the following sub-categories: water resources policy and administrative management; water resources protection; water supply and sanitation (large systems); water supply and sanitation (small systems); river development; waste management and disposal; and education and training in water supply and sanitation. According to the DAC classification, dams and reservoirs are considered primarily for irrigation and hydropower use, and are therefore classified under agriculture and energy sectors, respectively. The inclusion of waste management and disposal refers largely to solid waste-related activities, and does not represent a considerable portion of the total. Notably, in June 2004 the DAC Working Party on Statistics revised the sub-sector "water supply and sanitation – small systems" to "basic drinking water and basic sanitation", in order to allow for more targeted data collection relating to the MDGs in the future. As this report is based on data gathered through 2003, this new sub-sector is not included..

4 DAC members are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Italy, Ireland, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States and the Commission of the European Communities.

5 The OECD has recently published two reports on ODA to water supply and sanitation, from which this section draws heavily. These are cited throughout the text. For further information about the DAC and Creditor Reporting System (CRS), see http://www.oecd.org/dac/stats/crs/crsguide.

## 2.2 Constraints to tracking donor flows

While the OECD DAC and CRS databases offer insight into the world of donor financing, there are some constraints. First, and perhaps most importantly, the relationship between funding and access to water supply and sanitation is neither direct nor causal, meaning that improvements in access data may not be directly related to the amounts of ODA funding that are provided. Rather, the relationship should be seen as a way of identifying those countries and regions where additional financing is needed, and then provoking thoughts about how additional funding that can be targeted, should be targeted to achieve lasting poverty reduction impacts.

In considering this latter point, it should be noted that the DAC/CRS databases do not capture off-budget sheet commitments from donor agencies to the water sector, such as guarantee schemes, which means that more innovative funding schemes – which represent a new type of thinking about targeting ODA – are unaccounted for. From a technical perspective, accounting for these flows may be complex.

Further, the trend away from project-based donor assistance towards budgetary support – where ODA is deposited into recipient government accounts without rules on how it can be used – may also impact the potential for analysing ODA flows to specific sectors. Understandably, budgetary support places greater responsibility on governments to allocate and manage government functions, which may be appropriate in some countries, but not in all. Varied merits of this approach to ODA funding aside, this shift may result in a loss of focus in ODA reporting at a sectoral level.

Finally, and specifically for small towns, the DAC/CRS tracks large or small systems rather than urban or rural areas. For small towns, which tend to fall somewhere in between, there is no easy way to differentiate financial flows over time.