



RESPONSE OF  
THE ASIAN DEVELOPMENT BANK  
TO THE REPORT OF THE  
WORLD PANEL ON FINANCING  
WATER INFRASTRUCTURE



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The Asian Development Bank (ADB) has participated actively in the World Panel on Financing Water Infrastructure, chaired by Mr. Michel Camdessus, and generally supports the Panel's recommendations presented to the 3<sup>rd</sup> World Water Forum in Kyoto in March 2003. These are broadly consistent with ADB's water policy and other related policies and strategies. Together with its development partners, ADB is committed to help implement the Panel's recommendations, and help finance water investments to improve and expand the delivery of water services, and to foster the integrated management of water resources. This response to the Camdessus Panel Report (the Report) is intended to situate the ADB's water-related work in the context of the Report and to provide stakeholders with ADB's perspectives on key issues.

## **The ADB Water Agenda and the Camdessus Panel Report**

The Report correctly emphasizes the centrality of water in reducing poverty and in stimulating economic growth. Although water is essential to human existence, one in three people in the Asia and Pacific region do not have access to safe drinking water, and one in two lack basic sanitation. Water security of the poor encompasses water for production and income generation; water, sanitation, and hygiene for health; sustainable environmental management, and reduced vulnerability to water-related disasters.

ADB's water policy notes that investments to improve the management of water resources and the delivery of water services are essential to reduce poverty. It promotes the concept of water as a socially vital economic good that needs increasingly careful management to sustain equitable economic growth. The conservation and protection of water resources in the region through a participatory approach are at the heart of the policy.

To help achieve the water-related Millennium Development Goals (MDGs), ADB promotes a national focus on water sector reform, and supports the adoption of effective national water policies, water laws, and sector coordination arrangements; the improvement of institutional capacities; and the development of a

national action agenda for the water sector. ADB believes that efficient delivery of water services is a key element in water management. Higher efficiencies will be a key factor in attracting resources to the sector.

To maximize the efficient availability of water, ADB promotes the integrated management of water resources, including assessments and investments. It also supports investments to improve and expand the delivery of water services, focusing on water supply and sanitation (both rural and urban), and irrigation and drainage. As in the Report, it promotes autonomous and accountable service providers, private sector participation, public-private partnerships, and community participation, emphasizing equity in access to water for the poor and underserved.

Cost recovery is key to sustaining investments in water that expand access. Costs, however, must relate to the efficient provision of services. Inefficiencies cannot be passed on to consumers. If the extreme poor need to be subsidized, they should be. The water sector, particularly in urban areas, must generate a considerable part of the financial resources needed to expand access.

## **ADB Comments on the Camdessus Panel Report Broad Comments**

The Panel has focused almost exclusively on financing water services in urban areas. Since the majority of Asia's poor live in rural areas, financing their access to safe water and sanitation is a critical task and must merit the attention of governments, donors, and financiers alike. Likewise, the Report gives insufficient attention to the problems of wastewater management. Expanded water supplies will mean increased wastewater. Investing in wastewater management facilities, and getting them to work efficiently, will be a crucial sector challenge.

The Report is overly optimistic on the volume of financial flows. Overseas development assistance (ODA) flows have to be considered in country contexts including country strategies and priorities to support water as well as other sectors. Nonetheless, a doubling of ODA for water would help in achieving the

water- and sanitation-related MDGs. Private flows are likely to be restrained unless local capital markets develop, or risk mitigation instruments are used on a large scale.

A stronger poverty focus is required in line with the outcome of the 3<sup>rd</sup> World Water Forum and the Stavanger conference on Water for the Poor. It is a myth that the poor are not bankable. Bankable projects should be specifically prepared for them.

Water is a finite resource and must be conserved. The reduction of nonrevenue water in Asia (currently ranging from 25-70 per cent in most water utilities) will significantly lower capital requirements for new investments and conserve water. It costs far less to reduce nonrevenue water than to expand capacity and perpetuate system inefficiencies.

Where capacity expansion is needed, capital investments in expanding water service must be accompanied by system improvements. Country water policies should incorporate this fundamental principle. Access can also be expanded by applying the results of research in new technologies that separate water use (e.g., for cooking, drinking, bathing, sanitation), and through natural means such as rainwater harvesting and storage. In conjunction, water quality must remain a key focus area – expanding access without ensuring quality would be counterproductive.

### **National Water Policies**

The Panel's recommendations to strengthen governments' water policies for water services and for water resource management are generally sound and supported. However, ADB believes that such policies should have a clear focus on improving the water security of the poor. Governments should include pro-poor water management as a key element in national poverty reduction strategies and associated programs with external support agencies. Also, transboundary water management issues should be pursued through regional cooperation programs that include the shared use of water resources.

Improved access of the poor to safe water must be achieved by better governance to secure their rights and entitlements, especially for women, through reforms to laws, policies, institutional mandates, and participatory processes for decision-making.

### **Increasing Managerial Capacity in Local Institutions**

The Report is right in stressing improved capacities. Increasing capital flows to water without building capacity to plan, invest, and manage the services and resources will be infructuous. Also, unless such

capacity is built, and demonstrated, private capital flows will be hard to attract. Equally, water efficiencies cannot improve unless capacities are strengthened.

It is agreed that funding from ODA and Multilateral Financing Institutions (MFIs) should be a high priority for capacity building. However, given the high returns on capacity building, reliance solely on grant funds will not be possible. Concessional and semi-concessional resources should be used for managerial capacity building as a matter of common practice.

The use of grant and technical assistance funds to support decentralized cooperation involving reputable public institutions can succeed only if set in a long-term framework of capacity building. Such frameworks, fully owned by utilities and local governments, should be a precondition for any investments in building managerial capacity.

The collection and publication of comparative performance data for different water authorities is indeed a spur to improve performance. Such performance data should be collected systematically, consistently, and regularly, and funding to ensure its collection and publication should be assured. Financial incentives should also be considered to improve performance,

### **Legal and Regulatory Environment, Corruption and Ethical Practices**

ADB agrees with the Panel's view that a well-developed legal and regulatory environment is crucial for improved delivery of basic services including water supply and sanitation. Strengthening the legal and regulatory environment through decentralization, corporatization, freedom from political interference, and utility financial and operational autonomy are central to ADB's operations in water supply and sanitation.

The Panel rightly points out that corruption and unethical practices subvert attempts to improve operating environments as well as drive away investment. ADB is implementing several initiatives designed to strengthen the transparency and accountability mechanisms of its member countries, as well as those of its own operations.

### **Community Initiatives and Service-Oriented NGOs**

The Panel has identified four main roles for NGOs and other civil society groups: (i) helping build user-managed schemes; (ii) advocacy for the poor; (iii) participation in open planning processes to ensure that poor people's needs are at the top of the development agenda; and (iv) scrutinizing the investment decisions of governments and donors.

ADB strongly supports the association of NGOs and civil society groups in water and sanitation projects. Community participation and consumer rights awareness components were introduced in an urban water supply project in Uzbekistan to improve the capacity of consumers to participate in project planning, implementation, monitoring, and management. In Bangladesh, an apex NGO has been recruited to bring together community-based NGOs in organizing water management associations. ADB has also approached NGOs to jointly identify key water sector issues and reach a consensus on a mechanism(s) for a substantive long-term ADB-NGO (and government) dialogue on these issues.

### **Local Governments and Water Providers at Sub-Sovereign Level**

ADB's Water Policy explicitly commits ADB to encourage and support the decentralization of water services to geographically defined autonomous and accountable service providers. The policy also states that the appropriate role of governments, including sub-sovereigns, is as service regulator, not service provider. Most ADB operational support for water services is delivered through sub-sovereigns and water providers. Rural water supply and irrigation projects are also mostly implemented this way, but with some nationally implemented programs as exceptions.

It is not easy to improve the credit-worthiness of local governments. There are few creditworthy local governments in ADB's developing member countries (DMCs) and only minor flows of mid- and long-term commercial lending directly to city governments for municipal development. The Panel rightly notes perverse incentives as the main handicap. ADB's actions to remedy this are in line with the Panel's recommendations to (i) provide incentives for good reporting by sub-sovereigns, (ii) promote a central agency to collect, publish and compare sub-sovereign's financial and management information, (iii) promote the rating of sub-sovereigns, and (iv) promote sub-sovereign transparency.

Because poor tariff policies are a key proximate cause of water sector under-performance, all ADB water sector operations involve tariff policy dialogue and advice, mainly for sub-sovereigns. Evidence suggests that water supply services in all large cities in Asian DMCs can be essentially self-financing (from water supply revenues) except probably for some proportion of capital expenditure programs, which should be financed commercially. Concessional terms for city water supply developments are not warranted; such funding for water could instead be directed to low income rural water supply areas and to fledgling urban wastewater management markets with large externalities.

ADB experience with private sector participation in the water sector confirms the Panel's findings that currently there is most potential for private investments in water operations and management rather than in infrastructure assets. This will require local currency financing for water assets. ADB will examine opportunities to facilitate local currency development financing.

Monitoring and reporting service performance of local authorities and sub-sovereigns requires improving. ADB addresses this by (i) providing financial and technical support to national and regional associations of water utilities, for instance the South East Asian Water Utilities Network, (ii) building the capacity of water regulators, and (iii) giving technical assistance for benchmarking water utility performance.

### **Private Investment and Operation**

The discussion of private sector participation (PSP) in water services has generally focused on large-scale operations involving multinational firms, and the Panel's report is no exception. ADB encourages PSP in water services and in water resources management. It is keen to promote PSP involving a full range of private enterprise, from small independent providers to medium and large national firms, to large multinational firms.

Within the region, major PSP alternative modalities have included BOT projects for treatment plants, operation and maintenance contracts, wholesale concessions for utility operation and strategic shareholding purchase in utilities. Most projects have focused on water treatment and distribution but some limited investment in wastewater management has occurred in recent years, and it is expected that such investments will increase in the future. There are generally a significant number of PSP alternatives that can be considered.

### **Promoting Local Capital Markets and Savings**

The availability of long-term fixed-rate debt from the local capital markets will benefit not only private sector borrowers for water infrastructure projects but also local government water service providers who are able to achieve categorization of a credit worthy status.

The shortage of long-term fixed-rate domestic currency loans impacts on both local governments and private investors who see opportunities in investing in water. ADB is developing a funding base to allow eventual lending on long-term fixed-rate local currency terms. The effort is being made on a country-by-country basis, with funding mechanisms in India and

the Philippines nearing completion. Progress is also being made towards funding solutions in the People's Republic of China and Thailand.

The Report refers to the recent exposure of large private water operators to foreign exchange risk. ADB expects that public-private partnerships will focus on risk-reward structures tied to actual expansion and improvement of water services. The effective use of local currency borrowing structures as a financial risk mitigant is an important means of focusing on this objective.

### **International Commercial Lending**

Although ADB has played a limited role in financing private infrastructure projects in the water sector so far, it expects that lenders for water projects are likely to make a greater demand on direct guarantees for political risk and contract breach risks.

ADB believes that private sector lending for water services is not constrained by a lack of debt alternatives but rather due to lack of investor equity capital. MFIs should help establish an enabling environment for sustainable private water service projects to facilitate eventual equity investments by skilled and experienced water operators.

Concession contracts are generally difficult to debt finance with heavy requirements placed on shareholders to guarantee operations during early years when concession economics are still tenuous. With recent difficulties experienced in high profile water concessions, there are serious questions as to whether they can be financed on a limited recourse basis until certain defined technical and financial performance targets have been achieved.

### **Multilateral Financial Institutions**

The Panel has recommended that greater attention be paid to the potential role of sub-sovereign entities, and that MFIs lend directly to them. This is supported. Currently, ADB provides loans to such entities through its public sector operations but these are supported by sovereign guarantees. However, future lending to public sector sub-sovereign entities without the need for any supporting sovereign guarantee is currently being examined within ADB.

In the context of guarantees, ADB currently uses two instruments. These are the partial credit guarantee and the political risk guarantee. The latter instrument, which provides coverage against certain well-defined political risks, was re-launched in 2001 and the revamped product is likely to attract increased private sector participation in the infrastructure sector.

The Panel has recommended that MFIs resume lending for large water resource projects including those involving dams and storage. ADB has not declined to finance such projects where needed, but its water policy advocates that a cautious approach be followed given the record of environmental and social hazards associated with such projects.

The Panel's recommendations do not seem to reflect a range of valuable recommendations made by the World Commission on Dams (WCD) in its report. ADB welcomes further dialogue in its DMCs on the implementation of the WCD's recommendations. Alternative options should be considered including smaller storages, rainwater harvesting, community surface and ground water storage, and shallow tube wells that require much less capital investment and can be supported by local communities or by the private sector.

The Panel's recommendation that any new instruments or funds to be created for the water sector should be located in, and coordinated by, the regional development banks is supported. The Report correctly recognizes that regional development banks are in close touch with regional water strategies and partnerships and can maintain links with communities and have an awareness of local circumstances. *Asian Water Supplies – Reaching the Urban Poor*, a guide and sourcebook on urban water supplies in Asia published by ADB in 2003, provides a good illustration of such community links and local awareness.

### **ADB Follow up on the Camdessus Panel Report**

Expanding access to safe water and sanitation and simultaneously conserving a vital natural resource is a key development challenge of the current century. The Report is a timely reminder of the urgent need for additional financial resources to be mobilized within and for the water sector. ADB will pursue a range of actions to further promote financing for water services and water resources management.

*Sector Efficiencies.* ADB will promote innovation, synergies, and partnerships in developing the architecture required to enhance financial flows to water infrastructure and management. It will persuade its DMCs to visibly improve sector efficiencies and adopt effective water policies, create greater public awareness, establish credible regulators, develop systems to recognize and administer water use rights, increase water use efficiencies and reduce non-revenue water, and generate demand from water users and civil society organizations to realize and monitor much-needed water reforms and build capacity at all levels.

*Water for the Poor – Partnerships for Action.* ADB will catalyze water financing for the rural poor under this initiative launched at the 3<sup>rd</sup> World Water Forum by ADB and its collaborating partners. The initiative is being piloted in Viet Nam and will be replicated elsewhere. Its scope includes rural water supply and sanitation, water for livelihoods and sustainable environmental management, and investments to reduce vulnerability to water disasters. Private sector participation will be promoted through innovative approaches in rural water supply, sanitation, and groundwater irrigation.

*Water for Asian Cities.* ADB launched this program at the 3<sup>rd</sup> World Water Forum together with UN-Habitat to improve water supply and sanitation services for the urban poor. The program has commenced in India, and will be expanded. Reduction of non-revenue water will be pursued as a part of investment projects to be prepared with the help of this program.

*Sanitation and Wastewater.* Both basic household and community sanitation, and the management of ever increasing volumes of wastewater, are becoming critical development issues. In order to comprehensively assess the problems, solutions, and political economies of successful interventions in sanitation and wastewater management, ADB is planning to organize a regional consultation in collaboration with development partners.

*Managing Water Resources.* Building water infrastructure must be premised on sound assessments and be accompanied by strong management capacities and participatory decision making. ADB is helping finance the development and management of water resources within well-set national water policies. It will seek to increase financing for the necessary water sector assessments, river basin planning and management organizations, and for the resulting investment plans including infrastructure, services, conservation, and capacity building at national, basin, and local levels. A strategic and collaborative approach among partners will be developed to meet the huge financing needs.

*Improved Irrigation Efficiencies.* In many DMCs, agriculture remains the dominant user of developed water resources, yet many irrigation systems are plagued with low water use efficiency in an environment of fierce competition for water in water scarce basins. ADB will help establish virtuous cycles of investment, user charges, and operation and maintenance, with reforms of irrigation agencies to become autonomous and accountable service providers, management transfer to water user associations, and application of demand management tools such as pricing, regulation, and awareness. ADB will also encourage the development of multipurpose irrigation systems to support domestic water supply, aquaculture, and livestock to meet the diverse water needs of rural areas.

*Flood Management.* Flooding is a recurrent phenomenon in many DMCs in Asia, and the poor are particularly vulnerable. They lose employment, livestock, and standing crops, their homes are damaged, and they are exposed to disease caused by deteriorated sanitation. ADB will enhance flood management capacities of DMCs through integrated flood management based on river basins, and through a combination of structural and non-structural flood protection interventions. Improving people's coping capacities to secure their livelihoods under flood events in rural areas will be adopted as measures for self-help flood proofing, along with improved flood forecasting and disaster management systems.

## **Summary**

The global objectives seeking, by 2015, to reduce by half the number of people without sustainable access to safe drinking water and sanitation is a huge challenge. The Camdessus Panel Report has concentrated the minds of stakeholders, and the international community in particular. Translating its recommendations into action will take more than money and time. It will require commitment and dogged determination. ADB is committed to help its DMCs meet the challenge and slake the thirst of their peoples.

