

Introduction

Overview

This report examines innovative financing mechanisms that can help attract new financial resources into water and sanitation services (WSS). A particular focus is placed on mobilising market-based repayable financing (such as loans, bonds and equity) as a way of bridging the financial gap to meet the Millennium Development Goals and other crucial sector objectives. The Camdessus and Gurria reports, published in 2003 and 2006 respectively, formulated a number of recommendations in this area.* This report examines the extent to which these recommendations have been implemented and how financial innovation may need to adapt to the rapidly evolving global context and the ongoing financial and economic crisis.

Market-based repayable finance is difficult to mobilise for WSS due to a number of constraints, which are referred to as “critical mismatches”. A key constraint is that the sector is often perceived by potential providers of market-based repayable finance (such as banks, institutional investors, private equity funds, equity investors, project sponsors, etc.) as a “high risk/low return” sector when the fundamental economics of the sector (with relatively stable and almost “recession-proof” demand for the services and long-life buried assets) would rather place it in the “low risk/low and steady return” category.

This report investigates how innovative financing mechanisms can help shift those perceptions in order to attract repayable finance so as to finance critical investments. It assumes that other reforms can be carried out in parallel (as described in the Gurria report, World Water Council, 2006), such as tariff and governance reforms in particular, to ensure that strong and stable revenue flows are generated so as to reduce risk and enable repayment of external finance over time. Whilst the present report fully acknowledges the need for such hard policy choices to be made (particularly on the issue of tariffs),

* Winpenny, J. (2003).

it does not go into detail about how this could or should be done, as this is addressed in the background reports for the Horizontal Water Programme, such as the report on private sector participation (OECD 2009c) and the report on tariffs (2009d) as well as previous water-related OECD work.

In the context of the financial crisis, many sources of repayable finance have dried up and innovations that previously allowed improving the credit rating of a given entity (and thereby reducing its costs of borrowing), such as bond wrapping or securitisation, have largely disappeared. More than ever before, public finance has a role to play in leveraging market-based repayable finance. This may not necessarily require higher volumes of public finance but a more targeted use of such scarce resources. For example, building domestic institutions that channel international public finance at the decentralised level may be a very appropriate use of scarce public funds.

This report looks into the experience of developing innovative financial instruments in OECD countries as well as in middle-income and developing countries and investigates how specific country experiences could be usefully applied and scaled-up in other countries. Particular focus is placed on financing provided to asset-holders and water service operators (public, private or community-based) but also, to a degree, to households themselves when they are in charge of investing (for example, to build household latrines). This excludes financing to the sector as a whole for policy development.

Target audience

The readers targeted by this Report are policy makers in both OECD and non-OECD countries concerned with water, environmental policy, finance and development. The Report addresses specialists, but is also intended to be accessible to non-specialist readers. With this in mind, it tries to be jargon-free and sparing in its use of technical vocabulary. The objective is to explain potentially complex financial structures to the non-specialist and to increase awareness of the significant contribution that innovative financing can make for providing WSS for all.

Structure of the report

The report has four chapters:

Chapter 1 sets the stage. It starts by defining potential sources of finance for water and sanitation services (WSS) and sets out why this report focuses on how to attract market-based repayable finance to the sector and why innovation may be required to do so. It then recalls the recommendations made by the Camdessus and Gurría reports in this area and reviews the changes that

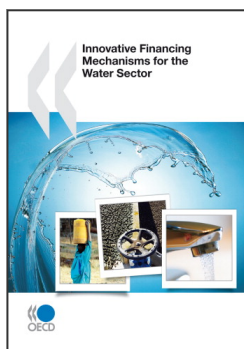
took place in the sector since then, which may call for a change in emphasis in the way those recommendations are taken into account.

Chapter 2 examines how market-based repayable finance can be mobilised in the water sector for different types of potential recipients. It seeks to evaluate why, in practice, such financing sources have failed to develop in a significant way, due to a number of “critical mismatches”. Finally, it summarises what are key drivers for financial innovation to attract market-based repayable finance.

Chapter 3 looks in more details into the set of innovative financial instruments that can be used in the sector. It reviews how such tools have been used over the last ten years and examines in more detail Official Development Assistance (ODA) can be used to catalyse market-based repayable finance into the sector.

Chapter 4 reviews how the global financial crisis is likely to affect the potential development of such financial innovations going forward and what the implications for the role of public finance are.

Finally, the bibliography contains a list of the key references for this report.



From:
Innovative Financing Mechanisms for the Water Sector

Access the complete publication at:
<https://doi.org/10.1787/9789264083660-en>

Please cite this chapter as:

OECD (2010), "Introduction", in *Innovative Financing Mechanisms for the Water Sector*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/9789264083660-4-en>

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to rights@oecd.org. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at info@copyright.com or the Centre français d'exploitation du droit de copie (CFC) at contact@cfcopies.com.