

### OECD – GIZ Conference: Closing the gap for water in line with SDG ambitions: the role of blended finance

4 -5 October 2018, Eschborn, Germany

#### "Water pays for Water – a Paradigm from the Past?"

- Klaus Gehr

"Water pays for water" has been the prevailing paradigm of multilateral and bilateral developmental financiers for the last decades. It means that water tariffs should allow for financing operation and investments. Fine, but this simply did not work – in most cases and for most of the time. By the way, it hasn't worked in Europe either.

Despite all sector reform efforts most of the water utilities in many developing and emerging countries are unable to raise tariffs that operate the system sustainably; leaving alone re-investments or much needed expansions of the system. And I do not even raise the issues of waste water treatment, including safe use or deposit of sludge.

To make matters more complicated, many water utilities in Africa desperately need better governance, more competent management and a regulator that is not hostile to the utilities. Success stories of other infrastructure sectors such as power, telecoms, ports and airports clearly show that sector reform is possible. Yet, I believe that even if the utilities are able to do their housekeeping, tariffs will not be enough to pay for all these challenges.

Water utilities should be able to secure pre-defined service levels of drinking water at a given quality standard and/or ensure a safe discharge and treatment of waste water and faeces. How could this be achieved? Good management of the utility (reducing water thefts, closing leakages, define service levels), a conducive regulatory regime and sector governance are the initial steps. Although block tariffs are widely used to make sure the indigent also have access to water it is the government's obligation to protect poor people's interest.

As safe and sufficient drinking water is also in the interest of the governments, it justifies them to assist funding the water sector. However, a smart targeting of subsidies is vital and competition between utilities on scarce public funds is helpful to support those utilities who strive for better performance. Public funds should primarily be used for infrastructure and increasing performance efficiency rather than permanently funding operating costs. In particular this holds true where the government also has an interest in raising standards e.g. the adoption of EU standards in the Western Balkan region or in expanding services to financially unviable customers.

When utilities raise funds for investing in infrastructure more efforts are needed to tap locally available sources. In many countries institutional investors such as pension funds are predominantly investing in treasury bills. Longer term loans or bonds could ultimately constitute an asset class quite attractive to pension funds and the like: with somewhat modest but steady revenue streams and a moderate risk profile. At the same time utilities could avoid running into currency mismatch risks that they have to bear when funding investments with loans in foreign exchange denominated loans.

Development Financing Institutions can assist in the implementing sector and utility reforms. They can also change their funding mode in many instances towards a more catalytic approach that enables utilities to raise more funds without currencies mismatch problems. In the long run, water may not completely pay for water/waste water projects. But in many cases water companies have an enormous potential to narrow the funding gap and thus the viability gap.

*Klaus Gehr is the Head of Division at KfW, a German government-owned development bank.*