Blended finance and the water sector – four risks to consider

european network on debt and development

Eurodad welcomes the Organisation for Economic Cooperation and Development's (OECD's) actions to open up debate on blended finance[1] and the water sector.

We agree that financing for safe drinking water, sanitation and hygiene is a crucial issue. Access to safe drinking water and sanitation is a human right,[2] and is fundamental to the enjoyment of other rights such as the highest attainable standard of health.[3] Under Sustainable Development Goal 6, the global community has committed that, by 2030, all people will have universal and equitable access to safe and affordable drinking water (target 6.1) and access to adequate and equitable sanitation and hygiene, including an end to open defecation, with "special attention to the needs of women and girls and those in vulnerable situations" (target 6.2).[4] Yet in 2015 more than 840 million people worldwide did not have access to a basic drinking water service, and 2.3 billion people lacked a basic sanitation service.[5] A World Bank study estimated that the capital costs alone of meeting SDG targets 6.1 and 6.2 would be around 114 billion USD per year.[6]

How best to source this finance is an urgent question. This briefing sets out four risks that we hope will be thoroughly considered in the forthcoming discussions. Wherever relevant it draws closely on the OECD Development Assistance Committee's (DAC's) Blended Finance Principles, which were agreed in October 2017 as a framework "to ensure blended finance meets accepted quality standards and achieves impact, based on a development rationale".[7]

Risk 1: leaving people and countries behind

Enjoyment of the right to safe drinking water and sanitation is subject to severe geographic and demographic inequalities. For example: in 2015, less than a third of the population of Least Developed Countries had access to a basic sanitation service, with the proportion being even lower in rural areas. [8] Low-income segments of the population can experience extreme disparities in access,[9] and marginalised groups such as women with disabilities tend to be particularly hard hit.[10]

Reaching these populations who cannot currently access safe drinking water and sanitation is key to meeting SDG 6. This requires building and – crucially - operating and maintaining[11] infrastructure in hard-to-access geographies, and providing services at low or no cost to marginalised populations. However, such interventions are "the very projects which are least likely to attract private investors",[12] as there is little prospect of short-term commercial returns.[13] The Overseas Development Institute recently argued that in many of the poorest countries, often the "fundamental economics are not right" for blending, as infrastructure projects lack secure streams of positive cash flows.[14]

The UN Inter-Agency Task Force on Financing for Development's 2018 report found that "the use of private finance is more challenging in areas where equity considerations and large financing gaps reduce profit prospects — such as water".[15]

In contrast, public finance is not subject to the same pressure to make a profit – one of the reasons why, historically, public sources have been the "mainstay" of water and sanitation infrastructure development worldwide.[16] In making the case for blending, it is often stated that public finance, and other 'traditional' sources of finance, are not sufficient to meet the SDGs' infrastructure financing needs. However, as a recent Eurodad briefing argued, the evidence does not bear this assertion out.[17] Solutions for mobilising significant sums of additional public finance are well known - such as clamping down on tax dodging, and meeting ODA commitments. Too much focus on mobilising private finance risks detracting attention from the urgent challenge of putting these public financing solutions into practice.

Risk 2: undermining local ownership of development priorities

The OECD DAC Blended Finance Principles state that blended finance should "support local development priorities" (Principle 3a).[18] This draws on the established development cooperation principle that development priorities must be owned by countries in the Global South, and partnerships for development should put these countries in the lead.[19]

Yet in practice the complex governance of blending risks eroding local ownership and accountability, as past research has found.[20] What is more, blended finance has at times been explicitly used as a tool to advance donors' own policy reform objectives. An evaluation of European Union blending between 2007 and 2014 said that one motivation for blending was that the recipient government would be "more easily persuaded to adopt the reforms or conditions attached to the loan (e.g. increase in tariffs) since there is a substantial subsidy element". The evaluation gives the example of a water and sanitation project in Armenia.[21]

Risk 3: doing more harm than good

The OECD DAC Blended Finance Principles say that "blended finance should be based on high corporate governance, environmental and social standards" (Principle 1a), and that risks should be allocated in a "targeted, balanced and sustainable manner" (Principle 4b).[22]

However, past analyses illustrate the risk that blended finance mechanisms may have harmful consequences – ranging from the alleged grabbing of indigenous peoples' land,[23] to the use of tax havens by development finance institutions engaged in blending.[24] Weak transparency and absence of redress mechanisms (or in some cases the late development of them) have made matters worse.[25] Moreover, blended finance can pose debt sustainability risks,[26] going against the principle of balanced and sustainable risk sharing. As yet there is little detailed research on these risks specifically in the context of water and sanitation. However, the sector is likely to be particularly sensitive to any transgressions that do occur, due to the strong inter-dependencies between water and sanitation, health, and the finances of poor households, including a reliance on household level debt in some blended finance projects.[27]

Risk 4: no clear added value

The OECD DAC Blended Finance Principles emphasise that the use of blended finance should be "anchored to a development rationale" (Principle 1), which should be subject to monitoring and evaluation (Principle 5b). The Principles also state that blended finance should only be used when it mobilises or leverages commercial funds that would not otherwise have been available (Principle 2a). Blending uses scarce development finance resources, often diverting them from other purposes: without evidence of added value, such diversion is very difficult to justify.

However, as a recent report by the OECD recognises, the evidence base on the outcomes and impact of blended finance is not yet persuasive: "There is a greater need for blending practices to prove their leveraging effect", and "Little reliable evidence has been produced linking initial blending efforts with proven development results".[28] The evidence so far published on blended finance in the water and sanitation sector is a case in point: while it provides much useful information on blending processes, evidence on outcomes and impacts is as yet much thinner.[29]

This shortage of evidence on impact makes the OECD's current work on blended finance in the water and sanitation sector all the more welcome.

Conclusion: the need for caution

Financing universal access to safe water and sanitation is imperative for fulfilling human rights and achieving the SDGs. But, as this briefing has argued, mobilising finance carries risks as well as opportunities. In the case of blended finance, these risks include:

- Diverting attention from the fundamental issue of how to increase and improve public investment in water and sanitation services that reach the most marginalised people.
- Undermining local ownership of development priorities.
- Harmful consequences including human rights abuses, tax avoidance, and unsustainable debt burdens.
- Diverting scarce development finance from other vital uses, without sufficient evidence of impact.

In the absence of compelling evidence of effective mitigations for these risks, we reiterate our position that any moves to scale up blended finance are premature.

References

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