"Urban Sanitation: A brave new utility reality?"

- Alyse Schrecongost

This note offers some brief thoughts on water utilities' sanitation line of work. It doesn't suggest financing solutions; it assumes good governance is paramount in all scenarios. It very briefly frames a common contradiction that as a sector we tend to implement as a norm – project financing for urban sewerage is acceptable, project financing for non-sewered sanitation is generally not (apart from occasional treatment plants and pilots). A few discussion questions are posed at the end for dialogue about the potential roles for concessional finance and philanthropy in supporting system change.

Water utilities are often water and sewerage utilities. The concept of actively financing utilities to deliver non-sewered sanitation along with water and sewerage is considered normal in very few locations. Ouagadougou in Burkina Faso, various cities in Malaysia, and eThekwini in South Africa provide possible pathways. Those are different contexts yielding different outcomes, but all are based on comprehensive city-scale planning for pro-poor sanitation services integrating sewered and non-sewered infrastructure. Outside of these cases, the idea tends to solicit reactions ranging from passive skepticism to dismissal.

Resistance is sometimes based on principles of investments on private property necessarily being a private good issue. Urban households not benefitting from a public sewer connection must pay out of pocket for what the market offers, with limited finance or subsidy. There is an "if HHs pay they will take better care of it" response. And, there is a "**utilities cannot even get water services right**" response. This latter response assumes delivering non-sewered sanitation services, especially for the poor, would saddle utilities with an additional financial burden that they cannot manage.

Lending for high cost/HH sewerage projects is common, however. The de facto large subsidies per household that result are widely accepted. Yet, only small segments of a city are served by those subsidies and not often the poorest segments. If the new customers are too few, politically acceptable tariffs will predictably not cover operating costs. Connection costs often result in low connection rates along new lines. Utilities end up with predictably increased financial vulnerability, reduced credit-worthiness, and infrastructure in disrepair.

Non-sewered sanitation investments, met with much more skepticism, tend to be lower capex cost/HH. Smaller investments can more immediately improve sanitation for many, and importantly, turn them into rate payers. This approach is imperfect or incomplete in many situations, but it can grow and evolve with the city flexibly. With publicly financed and coordinated on-plot infrastructure and service delivery, tariffs could be lower and more feasible for households to pay than open market prices paid for irregular services. Indeed, in many cases, unserved households including the poorest, end up invisibly cross-subsidizing sewer costs with water bills *and* paying high prices to the private sector for sub-standard unsafe services.

Extending public *financing* (not subsidizing) to include costs of on-plot connections and containment at the city level could generate benefits in terms of reducing system-wide costs and increasing safe management. eThekwini and ONEA's programs reflect an understanding that individual households do not have the incentives or technical expertise to ensure safe containment. The resulting irregularities have public and environmental health consequences and can increase system-wide costs of sludge waste management. Expensive infrastructure deteriorates from underloading. Trucked systems lose time finding, opening, managing containment decreasing equipment and labor efficiency. Collected waste goes to open drains via straight pipes and illegal connections.

It's important to acknowledge that this quickly-pitched argument includes lots of "could" statements. We know what isn't working well. We know the sector has more work to do in estimating costs of utility-delivered non-sewered services. The points above are intended to nudge a more structured exploration of how financing for water and sanitation services could and should be discussed as a bundle and not as consecutive, parallel, or entirely separate issues.

Designing smart subsidy and economic regulation requires looking at the full picture of a utility's options and obligations. Taking this approach may reveal sustainable pro-poor mechanisms that improve utilities' financial viability and do not generate additional public subsidy. Limited but real cases do bear this out. Laguna Water's contract, for example, requires the company to deliver safe sanitation in any market where they sell water. This requirement has been pushing them innovate with business models and technologies that are new to the company and will be designed explicitly to reach the most marginalized communities.

Below, I outline a few questions below to help us think about how we proceed in the sector with a focus on the financing needs for water and sanitation combined, rather than each one in isolation

1. *What is the data/practical steps needed for non-sewered sanitation to be more legitimately mainstreamed into conversations about utility finance?*
2. *How does the utility finance sector think about the role of innovation in shifting cost curves for delivering public goods and reaching the poor; what has worked in the past? How do finance partners think about their role specifically, and how do they engage with borrowing countries or utilities on this question?*
3. *How do we illuminate perverse incentives in the finance sector and in the utility in a way that supports and amplifies voices of internal changemakers helping stakeholder groups – donors, ministries of finance, and utilities – work with each other to fix their leaky buckets?*
4. *How can finance be structured to strengthen the hand of accountability institutions to enforce delivery of an invisible public good that is difficult to monitor or understand?*

Alyse Schrecongost is a Program Officer at the Bill & Melinda Gates Foundation.