



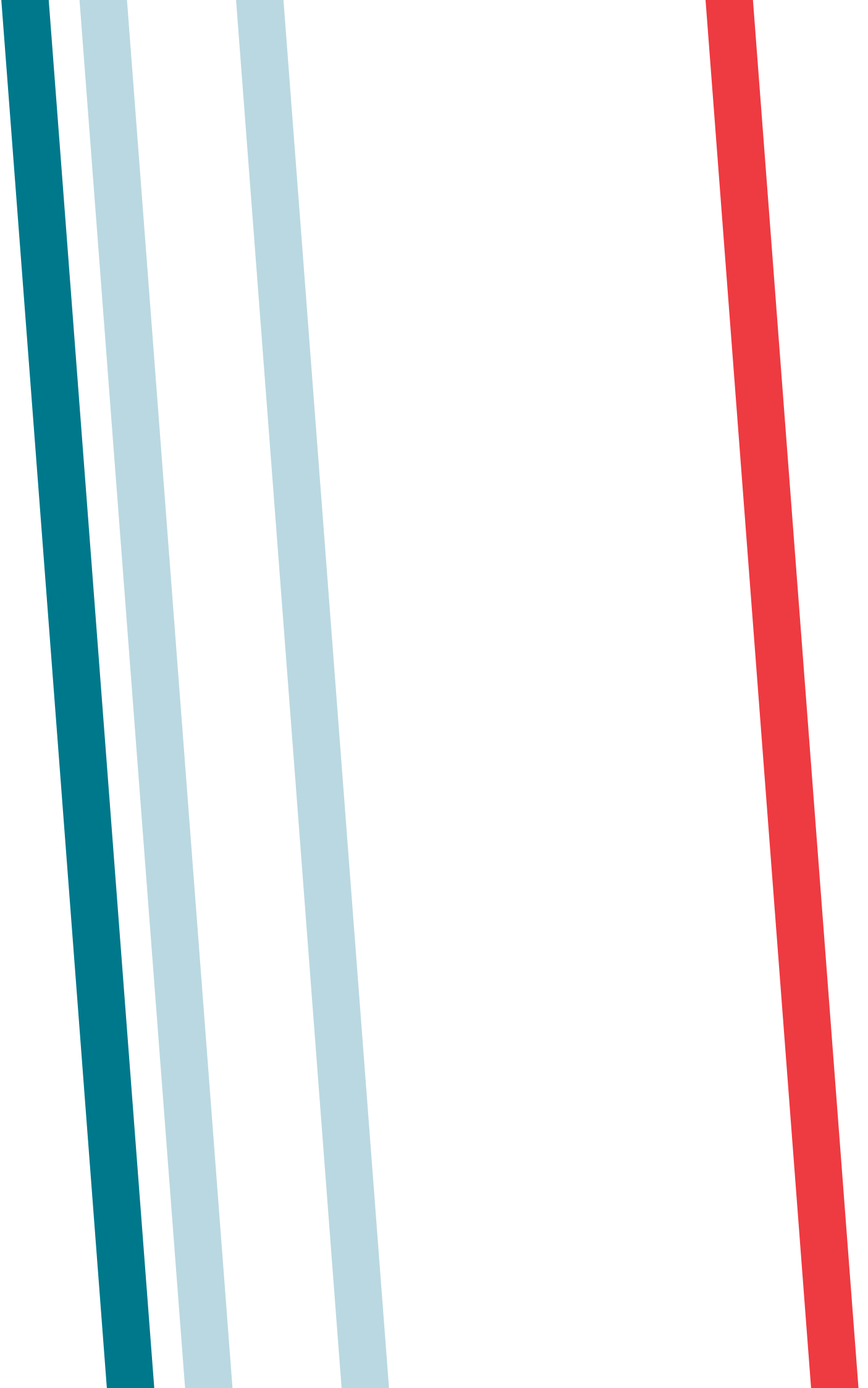
# Financing the 50/30 commitment: a financial framework for the WASH Strategy of the Netherlands Ministry of Foreign Affairs

Stef Smits and Evita Rozenberg



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# Acronyms and abbreviations

<b>3Ts</b>	Taxes, transfers and tariffs
<b>CapEx</b>	Capital Expenditure
<b>CapManEx</b>	Capital Maintenance Expenditure
<b>CoC</b>	Costs of Capital
<b>DGIS</b>	Directoraat-Generaal Internationale Samenwerking (Directorate-General for International Cooperation)
<b>ExpDS</b>	Expenditure on Direct Support
<b>ExpIDS</b>	Expenditure on Indirect Support
<b>IGG</b>	Inclusive Green Growth
<b>JMP</b>	Joint Monitoring Programme for Water Supply, Sanitation and Hygiene
<b>MFA</b>	Ministry of Foreign Affairs
<b>ODA</b>	Official Development Assistance
<b>OpEx</b>	Operation and minor maintenance expenditure
<b>WASH</b>	Water, Sanitation and Hygiene

## Executive summary

This paper aims to inform the discussions on financing the Ministry of Foreign Affairs' 50/30 commitment, by proposing a financial framework for the implementation of the WASH strategy for the period 2021-2030.

The first part of the document sets out such a framework, based on the review of literature, and consists of:

- Definitions of the various life-cycle costs.
- Sources of funding for these costs.
- Definitions of the terms of match funding, financial leverage and blended finance.
- A set of four strategies to reduce the gap between the costs and sources of financing, namely:
  1. Reducing costs by supporting measures that will improve efficiency either in capital investments or in the ongoing delivery of WASH services.
  2. Increasing sources of finance. This can be done through match funding or by promoting financial leverage. In addition, measures can be put in place – both at sector and service provider level – that would allow other sources of finance to increase. These are mainly around increasing revenues from tariffs.
  3. Mobilising repayable finance for current investments, that in future would need to be paid back through taxes and tariffs.
  4. Strengthening some of the foundational issues that are critical for attracting finance, as identified by Pories et al. (2019).

The second part of the document applies that framework to the context of the WASH strategy. In that, the document starts from the recognition that financing the WASH strategy is not merely a matter of mobilising funds for providing first time access to 50 and 30 million people. It is ensuring that the life-cycle costs of the 50 and 30 million people are financed adequately from a mix of financial sources.

By applying the framework, we are able to identify the current practice of how the various life-cycle costs are funded, what the gaps are, and what strategies could be adopted by the MFA. These strategies can be applied at three different levels: 1) within MFA, 2) at sector level in partner countries, and 3) at service providers or household level to be supported by the MFA.

Within MFA	Sector level in partner countries	Service provider or household level
<ul style="list-style-type: none"> <li>• Developing its own medium-term programming and expenditure framework</li> <li>• Establishing clear definitions and accounting rules for match funding</li> <li>• Ensuring as much as possible geographic and programmatic alignment between programmes aimed at capital investment in WASH and in strengthening (in)direct support</li> </ul>	<ul style="list-style-type: none"> <li>• Directing transfers and freeing up taxes towards the poorest populations</li> <li>• A measured use of blended finance</li> <li>• Supporting national tariff regulation</li> <li>• Support (partner) countries to develop financial strategies and plans</li> <li>• Contributing to a number of foundational issues in the enabling environment</li> </ul>	<ul style="list-style-type: none"> <li>• Using MFA funds (transfers) to promote self-supply where appropriate</li> <li>• Ensuring that service providers of water and sanitation systems set up with Dutch support apply an adequate tariff framework</li> <li>• Improving the operational and financial performance of service providers</li> </ul>

Many of these strategies would need to be interrelated. For example, strengthening the tariff collection at service provider level will need to be supported by adequate tariff regulation at sector level. That in turn is crucial in order to attract repayable finance.

Implicitly, some elements of these strategies are already in place. For example, some programmes supported by MFA are supporting service providers in having adequate tariff structures and working towards a healthy financial performance. Also, programmes and activities are undertaken at the enabling environment level, which would support blended finance mechanisms or adequate tariff regulation.

The document therefore recommends the Ministry to elaborate the identified strategies in more detail, so that – taken together – they would allow financing the ambitious targets set in its 50/30 strategy.

# 1 Introduction

## 1.1 BACKGROUND

In February 2017, the Minister of Development Cooperation and Foreign Trade Ms. Lilianne Ploumen sent the “WASH (Water, Sanitation and Hygiene) strategy 2016-2030” (further referred to as the WASH strategy) to Parliament (MFA, 2015). This strategy articulates the Netherlands’ contribution to the water and sanitation targets of the Sustainable Development Goals (SDGs). In line with SDG 6 that aims to ‘ensure availability and sustainable management of water and sanitation for all’ - it commits to providing 30 million people with sustainable access to safe water and 50 million people with sustainable access to improved sanitation (further referred to as the “50/30 commitment”). It also makes a commitment to ensuring sustainability of these services for a period of at least 15 years.

In various documents since then – including the new overall development cooperation policy “Investing in Global Prospects” – the Ministry of Foreign Affairs (MFA) confirmed the targets for the number of people to be reached with access to improved WASH services for the short term (annual basis), medium term (2020) and the long term (2030) (Table 1).

The WASH strategy contains a broad financial framework. It refers to the (unit) costs of the previous programming period (2012-2015) and comments on the possible validity of those data for the future. It also indicates the broad expected available budget estimate for WASH investments from the MFA (around 95 million Euro/year, or even up to 130 million Euro/year if all funds are included). Finally, it lists a number of strategies through which it seeks to mobilize (additional) funding to finance its commitment.

The MFA is now in the indicated transition period (from 2016-2020), in which new programmes will be started that are fully aligned with the new strategy.

The transition period will also be used to make analyses of the costs of reaching the commitments (amongst other based on number of people to be reached per country), and the degree of leverage to be obtained. The year 2020 will also be used to review whether there is a need to adjust the amount of ODA (Official Development Assistance) to be mobilised towards the commitments and the amount of third-party finance to be mobilised.

## 1.2 OBJECTIVE

This paper aims to inform the discussions in the transition period on financing the 50/30 commitment, by proposing a financial framework for the implementation of the WASH strategy for the period 2021-2030.

We consider that such a framework would be useful for the MFA, and its partners in order to have 1) a common understanding of key financial concepts, 2) a method for assessing the (unit) costs related to cost recovery, 3) clarity on who pays for what in order to finance the various life-cycle costs, and 4) broad strategies for mobilising the required finance.

## 1.3 STRUCTURE OF THE DOCUMENT

After this introduction, chapter 2 presents the conceptual framework. It details key terminology around life-cycle costs, the sources of financing of WASH services, and how these can be brought together. Chapter 3 presents the application of the conceptual framework. For each of the identified costs of WASH services provision, it indicates the current practices of financing these – as defined in the WASH strategy or otherwise. In addition, it identifies the main gaps in financing and suggests combinations of strategies to reduce the financial gap. Chapter 4 presents the overall reflections and conclusions of the application of the framework.

**TABLE 1. WATER RELATED TARGETS OF THE DUTCH MINISTRY OF FOREIGN AFFAIRS (MFA, 2018)**

Number of people with access to better water sources	8 million cumulatively (30 million cumulatively in 2030)	SDG 6
Number of people with access to improved sanitation and information on hygienic living conditions	12 million cumulatively (50 million cumulatively in 2030)	
Number of people benefiting from improved river basin management and safer deltas	20 million cumulatively	



## 2 Conceptual framework

The proposed financial framework for the WASH strategy contains concepts and terms related to: life-cycle costs of WASH services, sources of finance, financial leverage, match funding and blended finance.

### 2.1 LIFE-CYCLE COSTS

When referring to the costs of WASH, there is often lack of clarity on whether only the costs of the initial investment for developing WASH infrastructure is meant, or also other costs related to the ongoing service delivery. Therefore, the financial framework for the WASH strategy will use the terminology used under the life-cycle costs approach, which differentiates between the following cost components which need to be taken into account (Fonseca, 2007; Perry and Fonseca, 2010 a/b):

- **Capital expenditure (CapEx):** is the capital invested in constructing or purchasing fixed assets such as concrete structures, pumps, pipes and latrines to develop or extend a service. It may also include the one-off costs associated with water resources protection.
  - **Operating and minor maintenance expenditure (OpEx):** the regular and recurring minor expenditure on labour, fuel, chemicals, materials, and purchases of any bulk water, but also recurrent costs related to water resources protection. Most cost estimates assume OpEx runs at between 5% and 20% of capital investments.
  - **Capital maintenance expenditure (CapManEx):** expenditure on asset renewal, replacement and rehabilitation covers the work that goes beyond routine maintenance to repair and replace equipment, in order to keep systems running.
  - **Cost of capital (CoC):** the cost of capital is the cost of financing a programme or project; i.e. the cost of accessing the funds needed to construct a system.
  - **Expenditure on direct support (ExpDS):** includes expenditure on both pre- and post-construction support activities directed to local-level stakeholders, users or user groups.
  - **Expenditure on indirect support (ExpIDS):** includes macro-level support, capacity building, policy, planning, and monitoring that contribute to the sector's working capacity and regulation but are not particular to any programme or project.
- Note that these definitions include some water

resources management activities, in so far as they are directly related to WASH services provision, like source protection. It excludes broader water resources management strategies and measures, such as setting up catchment management agencies.

### 2.2 SOURCES OF FINANCE

There are three sources of funding for WASH services available, commonly referred to as the '3Ts' (OECD, 2009):

- **Tariffs:** are contributions to the costs of WASH services made by the people who use these services (WHO, 2012). Users generally make those payments to service providers for receiving access to and using the service (Fonseca, 2015). Though originally not defined as such, this source of finance also includes the users' own investment towards capital expenditure on WASH services, for example, where users build their own latrine or install their own well. This is also referred to as self-supply.
- **Taxes:** refer to funds originating from domestic taxes that are channelled to the sector. Most taxes in these countries are collected at national level and distributed to lower government levels according to an allocation formula, or – to a minor extent – collected at decentralised level, where they can be used for the WASH sector.
- **Transfers:** refer to ODA (Official Development Assistance) funds coming from development banks, international donors, and charitable foundations including NGOs and decentralised cooperation and local civil society organisations, which typically originate in developed countries (WHO, 2012). It can come in the form of grants or concessional loans.

Other sources of finance are often mentioned – such as micro-credit and other repayable finance –, but these eventually fall into one of these three groups. Micro-credit will usually need to be paid back by users (so tariffs), and loans are to be paid back through taxes or tariffs. Another source of finance sometimes mentioned are investments from private sector parties (such as factory owners) in WASH facilities at their companies but sometimes also for their workers in communities. These would also fall under the definition of 'transfers' as such investments are often done through the charitable foundations for corporate social responsibility.

### 2.3 ENSURING SOURCES OF FINANCE FOR THE LIFE-CYCLE COST CATEGORIES

For services to be sustainable, the (combination of) sources of finance need to cover the various life-cycle costs. This can be shown in the form of a financial balance, as shown in Figure 1.

The figure shows the sum of the main life-cycle costs on one side, and the various sources of finance on the other. This balance needs to be drawn up for a particular period (e.g. a year, or a couple of years). In that way, the one-off capital costs can be combined with recurrent costs, such as operation and maintenance, or direct support. The balance also needs to be drawn up for specific geographic areas. This can be an entire country, but also a subnational unit, such as a district, or other relevant unit for financial planning.

Within such a balance, there is often a financial gap. If that gap relates to capital expenditure, it means in essence that less people can be provided with new services than what is needed to reach a target. If the gap is in one of the recurrent costs, it eventually translates into a reduction in the level of service.

Based on where the gap(s) are in the financial balance, strategies can be identified to reduce the gap. Three main types of strategies can be identified:

1. Reducing the costs. This can come from efficiency gains, by getting the same level of service at a lower cost, e.g. through more streamlined procurement processes. In some cases, the costs can only be reduced by also lowering the level of service.
2. Increasing one or more of the sources of financing. Different strategies can be followed to increase each of the sources of finance.

3. Using repayable finance to bring forward the finance in time. By borrowing money, for example for capital investments, the financial gap at a particular moment in time can be reduced. This will need to be repaid in the future, either from taxes or tariffs. In other words, a current financial gap can be reduced by borrowing against anticipated increases in taxes and tariffs in the future.

These three groups of strategies are often interrelated, as the three sources of finance are not interchangeable. For efficient (and equitable) financial planning, the right mix of the sources of finance – particularly tariffs and taxes – is important. For example, it is common that taxes are channelled to utilities so that these can cover some of their OpEx and CapManEx needs, and keep tariffs low. In this way, the utility is not incentivised to perform more efficiently. Moreover, users who have access to water from such a utility are often wealthier than people who do not have access to water supplies at all. Taxes are then effectively used to ‘subsidise’ the recurrent costs of water provision to better-off segments of the population, at the expense of extending services to people who do not have access at all. This practice also limits the possibilities of a utility to attract repayable finance.

In addition to these three groups of strategies, there are also a number of foundational issues that would need to be addressed. Many limitations to the financing of the sector lie outside the WASH sector as such, and have to do with the policy, legislative or regulatory framework for example. Therefore Pories et al. (2019) identify 10 foundational issues that need to be addressed at three levels: 1) the sector level, 2) the service providers, and 3) within the supply of finance.

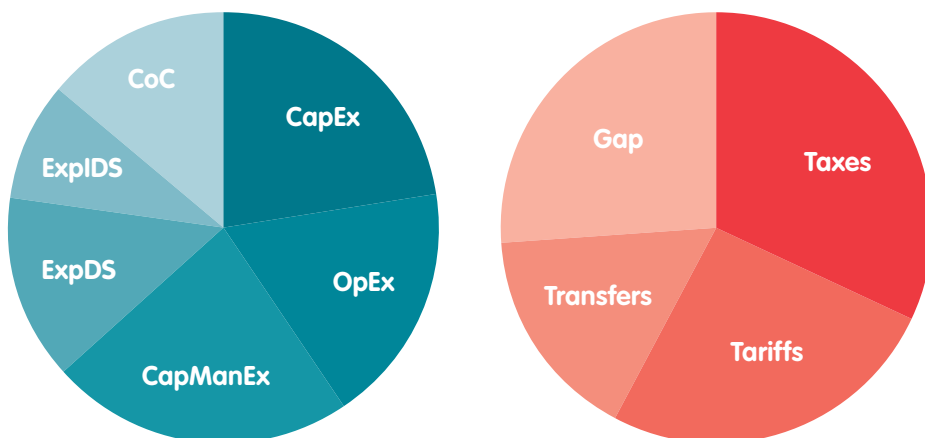


FIGURE 1. BALANCE BETWEEN THE LIFE-CYCLE COSTS AND SOURCES OF FINANCE

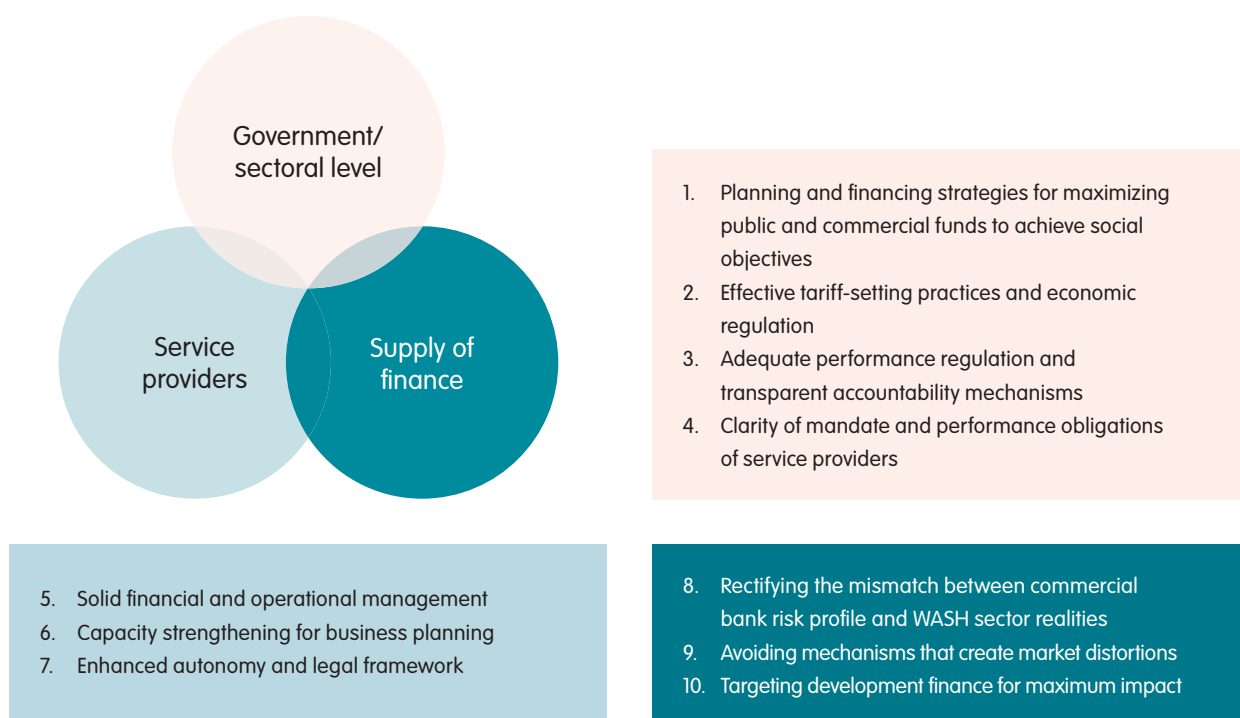


FIGURE 2. FOUNDATIONAL ISSUES FOR ATTRACTING FINANCE (SOURCE: PORIES ET AL., 2019)

## 2.4 MATCH FUNDING, FINANCIAL LEVERAGE AND BLENDED FINANCE

The WASH strategy refers to a number of concepts related to the increase of finance. This section seeks to define those.

**Financial leverage.** The Organisation for Economic Cooperation and Development (OECD) defines financial leverage as ‘the use of borrowed funds to increase profitability and buying power’<sup>1</sup>. If this definition would be applied to WASH, it would mean that funds are borrowed on the capital markets, for example for the extension of a water supply network. These would then be repaid through an increase in revenue from tariffs (more people would have a connection and would therefore be paying a tariff) or taxes (the government pays back the loan from its general taxes).

The WASH strategy seems to follow a broader definition of the term financial leverage. It refers – next to indeed mobilising private investments and micro-finance – also to leverage as getting user contributions and money from domestic taxes for the

1. Planning and financing strategies for maximizing public and commercial funds to achieve social objectives
2. Effective tariff-setting practices and economic regulation
3. Adequate performance regulation and transparent accountability mechanisms
4. Clarity of mandate and performance obligations of service providers

5. Solid financial and operational management
6. Capacity strengthening for business planning
7. Enhanced autonomy and legal framework
8. Rectifying the mismatch between commercial bank risk profile and WASH sector realities
9. Avoiding mechanisms that create market distortions
10. Targeting development finance for maximum impact

most hard-to-reach areas. This is understood not to refer to using borrowed money, but rather mobilising money from users and governments for direct investments.

**Matching funds.** The latter practice is usually referred to as matching funds. This is defined as the practice whereby the total costs of an intervention (usually for capital investments) are shared between transfers, taxes and tariffs. There is no borrowing of money involved.

Within that, the WASH strategy puts special emphasis on mobilising those as non-ODA funds. This means that funds that are obtained from another donor (so another source of transfer) would not be considered as matching funds. Only, funds obtained from households or partner governments would be considered matching funds. The logic behind it is that the Netherlands seeks to increase the total amount of funds in the sector. Using funds from other donors as matching funds rarely increases the total amount of funding, as that tends to come out of existing donor commitments.

<sup>1</sup> OECD Glossary: <https://stats.oecd.org/glossary/detail.asp?ID=1524>

<sup>2</sup> OECD DAC BLENDED Finance Principles for Unlocking Commercial Finance for the Sustainable Development Goals (2018), <http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/OECD-Blended-Finance-Principles.pdf>

**Blended finance.** A final related concept is the one of blended finance. The OECD<sup>2</sup> explains it as the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries. In essence, it is using transfers (as public money) to de-risk investments and make them more attractive to private money. By reducing the risks, private investors are more likely to invest in a sector such as WASH and get a return on their investment. At the same time, these investments will result in development impact.

There is the expectation that when applied to WASH, it could unlock some much-needed financial flows to the sector (Fonseca, 2018). With the proper enabling environments in place, it can unequivocally provide financial relief to the WASH sector, which has often been criticised for lagging behind in attracting alternative sources of finance. Blended finance is unlikely to be the full panacea for all the financial gaps in the sector.

Though the WASH strategy does not use this term, it refers to a number of examples of blended finance it would support (such as the development of Water Finance Facilities) as well as the critical need to strengthen the enabling environment that is essential for blended finance to work.

#### **Uniformity and consistency in definitions**

The above implies that the WASH strategy refers to the three closely related – but different – concepts of leverage, matching funds and blended finance, but that it does not follow the official OECD definitions, and uses these concepts interchangeably.

This may lead to confusion and limited uniformity in applying these definitions among MFA's partners. For example, Bhattacharjee and Emtiaj Uddin (2017) describe in detail the definitions of leverage followed in the WASH Alliance International (WAI) programme in Bangladesh and how this was calculated. That again uses slightly different definitions, and hence different ways of accounting for this. If this is an agreement made at programme level, then such agreements need to be honoured. If these definitions differ across programmes, it would be very difficult to compare and sum up the amount of leverage generated across all MFA-supported programmes.

For the remainder of this document, we will use the official OECD definitions and seek to apply these in a uniform and consistent manner.

## 3 Applying the conceptual framework to the WASH strategy

This section applies the conceptual framework elaborated in the previous section. For each of the life-cycle costs, we indicate 1) the current practice of financing these under the WASH strategy, 2) identification of potential financial gaps, and 3) strategies that MFA and its partners could follow to reduce the financial gap.

### 3.1 CAPITAL EXPENDITURE

#### 3.1.1 Current practice

It is expected that a large portion of the financing of MFA would be going to CapEx, as it is generally understood that the 50 and 30 million people it aims to reach would get first-time access, which by definition implies investing in CapEx.

As the WASH strategy also makes clear, not all the capital expenditure would come from transfers from the MFA. Part would come from what are essentially matching funds, i.e. investments from households themselves and from partner governments.

Some of the examples used in the WASH strategy also suggest that part of the capital expenditure to reach the targets would come from repayable finance mechanisms, such as the aforementioned Water Finance Facilities. In that case, funding from the MFA would be used to establish such mechanisms for repayable finance or to de-risk it through blended finance. The actual investment would be done by private investors, and eventually paid back through tariffs and transfers. In that case, MFA's contribution effectively is only to a minor extent one towards CapEx, but rather one to (In)direct support costs (for establishing these kinds of facilities or mechanisms) or to Costs of Capital (e.g. subsidised interest rates).

#### 3.1.2 Gaps

Estimating the extent to which there is a gap between the costs and the sources of financing for reaching the 50 and 30 million is difficult. There are three main reasons for this: 1) inherent difficulties in estimating the costs, 2) lack of clarity on matching funds and 3) limited opportunity to programme for these numbers of people to be reached. These reasons are further elaborated below.

#### Inherent difficulties in estimating costs

There are a number of inherent difficulties in estimating the costs for reaching the targets.

- *Definition of level of service for first-time access.* The strategy makes it clear that the MFA will directly support 50 and 30 million people with first-time access. It is not clear, however, whether this is with a basic or safely managed level of service (as defined by the JMP - Joint Monitoring Programme for Water Supply, Sanitation and Hygiene), as those definitions didn't exist at the time of issuing the commitment. Considering the context and focus of many of the programmes supported by the MFA, it can be assumed the majority would get a basic level of service, but through utility-focused programmes, probably part of the 50 and 30 million could get a safely managed level of service. The two levels of service have different levels of costs associated with them. Without an indicative break-down of the targets, it is not possible to get a detailed estimate of the costs needed for capital investments.
- *Variation of unit costs across and within countries.* Unit costs for capital investments differ widely between and within countries. Unit costs for the same level of service tend to be higher in remote rural areas (because of lower economies of scale), but service levels in urban areas are usually higher, resulting in higher unit costs. As Hutton and Varughese (2016) show in their calculation of the costs for reaching the SDGs, unit costs also vary a lot between countries.
- *Ranges of unit costs.* Studies such as the one by Hutton and Varughese (2016) use median unit costs. Earlier work of WASHCost showed that the ranges of costs are very wide. This means, a median cost can be used for planning. Actual costs may deviate significantly from that because of very location-specific conditions.
- *Variation of unit costs over time.* Though little detailed insight exists in this, it is likely that unit costs will change over time within countries, due to factors such as demographic growth, inflation, efficiency in programme execution, reduction in prices of technologies, and many others. Some of these factors may counterbalance each other,

whereas others will reinforce each other. This makes cost projections over a time period longer than a few years very unreliable.

Making detailed estimates of the total costs would require knowing beforehand how many people are to be reached where (in which country; in rural or urban areas; even within which part of a country), at what moment in time and with what service level. Even if such estimates could be made, there would probably be a wide range of total costs.

For that reason, the WASH strategy uses the unit costs of the past as prediction for the amount needed in the future. Whereas that is valid for broad planning, it has as drawback that in reality, costs may be significantly higher or lower for the reasons mentioned.

#### **Unclear definitions of matching funds**

As discussed in section 2.4, a key strategy of the MFA is to ensure matching funds are obtained from users and domestic finance. However, no targets or reference values are set for those. They tend to be defined for specific programmes. Nor is it defined for MFA partners what counts as matching funds and what not. This makes it impossible to track these amounts in a uniform matter.

#### **Partial possibility for programming**

The number of people reached by the MFA is calculated as the sum of:

- *The people reached by WASH programmes funded by the IGG department and the embassies.* The MFA has most control over programming for this part of the target. It knows the budget and expenditure made by IGG and the embassies on WASH programmes (around 95 million Euro/year), knows broadly what percentage of that goes into capital expenditure, and the partners report back how many people have been reached. This also means that IGG and the embassies have the potential to do programming based on this budget towards the targets.
- *The people reached by other infrastructure programmes.* There are a number of broader infrastructure programmes of the MFA, such as DRIVE, which can be used for WASH infrastructure development. The partners who execute these programmes report back on the number of people reached with WASH, and the budgets for WASH infrastructure are also known. Under these programmes, it is difficult to programme a priori what percentage goes to WASH, and what to other types of infrastructure. Though the results and

expenditure contribute to the achievement of the 50/30 commitment, these cannot easily be proactively planned for.

- *Contributions from multilateral institutions (toerekeningen).* The MFA provides general financial contributions to multilateral institutions, such as the various UN agencies and development banks. A proportional part of the results obtained by these institutions in WASH, is then attributed to the MFA. Though these results count towards the 50/30 commitment, they cannot be proactively planned for. They are part of the overall development portfolio of these institutions.

All in all, this means that MFA can do the programming (and hence the budgeting and financing) for only part of the target, even though that is probably a relatively large part of the target. Nevertheless, it only has partial control over the budgets available.

Getting detailed insight into the financial gap is therefore very difficult, and full of uncertainties. Nevertheless, it is possible that this gap exists, or that financial resources are limited considering the investment needs.

#### **3.1.3 Strategies**

In order to address the financial gap in investments, a number of strategies could be followed, to get a better insight into the size of the financial gap and the instruments available to reduce them. In addition, MFA needs to develop strategies at the level of countries where it supports the sector, particularly on defining which source of finance is to be used for which segment of the population. Finally, there are strategies at the level of households and service providers it supports.

*Internal strategies related to a better insight into the size of the financial gap and mechanisms for reducing those*

#### **1. Developing a medium-term programming and expenditure framework**

As argued above, getting a detailed assessment of the financing gap for the entire period up to the 2030 capital investments is difficult, and fraught with many uncertainties. At the same time, the kind of broad estimates of the total costs, as presented currently in the WASH strategy, is not very helpful.

An intermediate approach is to develop a gap analysis for the medium term, whereby the medium term

would be defined as 3–4 years on a rolling basis. On that time frame, the MFA would have a reasonable insight into how many people are to be reached where, as most WASH programmes have a duration of several years. An example of how such programming can be done is provided in Annex 1. Within that time frame, a good insight can be obtained into the current financial commitments to these programmes, both centrally funded and from embassies.

Based on that, the MFA can assess for the upcoming period, how many people are to be reached – and at what costs – through their current programmes, and eventually what the gap is, both in people to be reached and investments required. Further programmes can then be defined and – where needed – finance mobilised.

In this way, political developments such as shifts in focus countries or priorities in Dutch development cooperation can be taken on board.

## **2. Establishing clear definitions and accounting rules for match funding**

A next step in dealing with a potential financing gap is then defining clearly what is match funding, and how that should be accounted for. This then needs to be applied and followed by all partners. By following uniform procedures for match funding, better insight can be obtained whether there is a financial gap; and if so, how much it is.

*Strategies at sector level*

## **3. Directing transfers and freeing up taxes towards the poorest populations**

The poorest segments of the population – by definition – have least capacity to contribute to the capital costs of WASH service provision. It is to those groups that scarce public sources – either transfers or taxes – for capital investments should be directed. The segments of the populations that have a higher capacity to contribute to the – capital or recurrent – costs of services, should be served through blended or fully repayable finance.

This in turn implies that good insight needs to exist into the levels of access to services among different wealth groups, and how public finance flows are going to different wealth groups. Based on that, MFA's transfers to WASH should be directed mostly to the poorest wealth quintiles. In parallel, MFA should advocate for also directing taxes to those wealth groups and promote the use of blended or repayable finance for the richer wealth groups.

## **4. Promoting and supporting blended finance in a measured way**

As argued above, there is need to attract private finance to the WASH sector, given the enormous financial need. This will not happen by itself without the public sector de-risking that. The implication of this is that private investors will get a financial return, where the public sector bears the risk. This means that the MFA should promote and support blended finance in a measured way, i.e. only under the following conditions:

- Where the eventual users of the attracted private finance will have the ability and willingness to pay higher tariffs in order to be able to pay back the loan.
- Where attracting private finance would help in freeing up public finance for the harder to reach groups. This reinforces the point made under the previous strategy.
- Where there is scope to quickly phase-out blended finance. Blended finance has a big risk of market distortion, in that it may crowd out existing commercial finance. It should therefore only be used to establish such mechanisms, and with a view towards phasing out.

*Strategies at the level of service providers and households*

## **5. Using MFA funds (transfers) to promote self-supply where appropriate**

One of the targeted sources of match funding is a household's own investment in WASH infrastructure, also referred to as self-supply. Mobilising this type of private investments is a particularly relevant strategy for sanitation, also given the fact that the WASH strategy puts so much emphasis on CLTS (Community-Led Total Sanitation) where households should build their latrines with their own means.

## **3.2 OPERATION AND MINOR MAINTENANCE AND CAPITAL MAINTENANCE EXPENDITURE**

For services to be sustainable, both OpEx and CapManEx need to be adequately covered, usually through a mix of tariffs and taxes. It is not likely that transfers can be used structurally to cover these costs. Only donor-funded rehabilitation programmes are an occasional source of funding for CapManEx.

### **3.2.1 Current practice**

It is generally expected that users cover OpEx costs out of tariffs. The WASH strategy puts strong emphasis on the payment of tariffs by users, so that utilities can cover operational costs out of tariff collections.

This is also reflected in the practices and indicators of various programmes. Rural programmes usually report on the indicators of tariff payments by users. For example, within the WaterWorX programme, utilities are supported to improve their financial performance by having adequate tariffs, including billing and collection efficiency.

### 3.2.2 Gaps

It is impossible to say whether tariffs, as applied in water supply systems that have been developed with Dutch support, are covering OpEx, or even CapManEx, fully. That would require doing a full analysis of the tariff structures in relation to expenditures of utilities and other service providers supported by the MFA. Moreover, this will often depend on the specific forms of economic tariff regulation that is applicable in the various countries.

However, generally tariffs in many lower income countries are set at levels inadequate to cover even minor maintenance, also public funds available at the district level in rural areas usually only cover salaries, not maintenance (Fonseca; Pories, 2017). In fact, the UN-Water Global Analysis and Assessment of Sanitation and Drinking Water (GLAAS) survey indicates that household tariffs are insufficient to recover operations and basic maintenance costs (UN-Water, 2017).

### 3.2.3 Strategies

In view of the above, the MFA should follow strategies at two levels: 1) at service provider level to ensure that these are able as much as possible to cover OpEx and CapManEx; and 2) at sector level to ensure adequate tariff regulation.

#### *Strategies at service provider level*

#### **1. Ensuring that service providers of water and sanitation systems that set up with Dutch support apply an adequate tariff framework.**

This strategy is in essence what the WASH strategy refers to already extensively and what is expected to be a common practice. It is also a specific area of attention in the sustainability checks that need to be carried out, to make sure that this actually happens. Such checks should have specific indicators on revenue from tariffs, and the degree to which these cover operational costs.

#### **2. Improving the operational and financial performance of service providers**

Reducing the financial gap on OpEx and CapManEx not only requires having adequate tariff frameworks,

and sufficient revenue. It also requires improving the efficiency of service providers, i.e. lowering the costs through operational and financial performance. Reducing non-revenue water, by reducing physical and financial losses has been and will remain an important element.

#### *Strategies at sector level*

#### **3. Supporting national tariff regulation**

However, utilities and other service providers (water committees) may need to follow country-specific tariff regulation. Such regulation may not be sufficiently detailed or conducive to high financial performance of service providers. For example, the regulation may not be specific enough regarding the fact that tariffs are expected to cover capital maintenance, or the tariffs are too low for many utilities to break even. In some (bilateral) programmes, the MFA can provide technical and financial support to the regulators on updating their tariff frameworks.

## **3.3 DIRECT AND INDIRECT SUPPORT COSTS**

### **3.3.1 Current practices**

The WASH strategy mentions that Dutch funding will be used to strengthen the enabling environment for WASH service provision. Further specifications are lacking but this would essentially include some of the (in)direct support costs. Examples include the work of UNICEF in strengthening the capacity of districts for WASH service delivery, and for national monitoring to happen; WaterWorX which has a dedicated component of strengthening the (national) enabling environment; and the work of IRC to strengthen the WASH system in some six countries across the globe.

These efforts are usually project bound. During the time of the project, transfers are used for structural strengthening of the enabling environment. The recurrent direct and indirect costs, however, will be mainly covered by local and national governments. The ongoing costs of (in)direct support are usually also covered from taxes, as a big part of these costs are salaries and transport costs of (local) government staff.

### **3.3.2 Gaps**

The practice described above is a logical one. Transfers could and should not be used to cover the recurrent costs of direct and indirect support; they should only be used for structural improvements in capacities and mechanisms.

However, the total expenditure of many countries on (in)direct support are very far below what is needed



for sustainable service delivery (Smits et al., 2011). In several countries, the amount spent on direct support ranged from 0.20–0.40 US\$/person year, whereas an amount of around 1 US\$/person/year would be minimum. Without addressing the gap in (in)direct support services will not be sustainable.

Even though the MFA is investing in reducing this gap, there is often a geographic mismatch. Not in all places where the MFA supports WASH investment programmes does it support parallel programmes to strengthen the enabling environment. In some of the places where it supports the strengthening of the enabling environment there are also WASH programmes.

### 3.3.3 Strategies

Addressing this gap mainly requires an internal strategy within MFA to address the geographic and programmatic mismatch.

*Strategies internal to MFA*

#### 1. Ensuring geographic and programmatic alignment between programmes aimed at capital investment in WASH and in strengthening (in)direct support

This can be achieved either by ensuring that MFA-funded programmes always combine elements of capital investment in WASH and strengthening the enabling environment. This would ideally be the most practical way of ensuring synergy between the two types of intervention. Where it is not possible to include them in a single programme, then ideally this should be done through complementarity between programmes that operate in the same country or geographic area. Special emphasis should be on bilateral programmes. Those will often be in the best position to develop programmes to strengthen the enabling environment in close coordination with partner country governments.

## 3.4 OVERALL STRATEGIES

Having seen the practices, gaps and proposed strategies for each of the individual life-cycle costs, this section proposes a final overall strategy of supporting partner countries to develop financial strategies and plans.

*Strategies at sector level*

#### 1. Support (partner) countries to develop financial strategies and plans

The sections above have given guidance on strategies for the MFA as a donor. This exercise should ideally also be done by the recipient countries. They will

need to assess the various costs and sources of finance to reach the SDG targets. This should include how the Dutch financial support to some of these costs will fit into the overall financial balance of the sector.

An overview from GLAAS (UN-Water, 2010) shows that only a few countries have such plans. This is to some extent understandable, as compiling the data on costs and sources of finance may be difficult, particularly where those data are not readily accessible. The MFA can support its partner countries in doing such an exercise, and in that way contribute to a strengthened enabling environment.

## 4 Conclusions

This paper aimed to inform the discussions on financing the Ministry of Foreign Affairs' 50/30 commitment, by proposing a financial framework for the implementation of the WASH strategy for the period 2021-2030.

To that effect, it developed a framework, identifying the various life-cycle costs, sources of financing and a number of generic strategies to reduce the financial gap and attracting finance for WASH.

By applying that framework for financing the WASH strategy, the paper has been able to identify a number of strategies that the Ministry could apply. These can be applied at three different levels: 1) within MFA, 2) at the level of the sector in partner countries, and 3) at the level of service providers or households to be supported by the MFA.

Many of these strategies would need to be interrelated. For example, strengthening the tariff

collection at service provider level will need to be supported by adequate tariff regulation at sector level. That in turn is crucial in order to attract repayable finance.

Implicitly, some elements of these strategies are already in place. For example, some programmes supported by MFA are already supporting service providers in having adequate tariff structures and working towards a healthy financial performance. Also programmes and activities are undertaken at the enabling environment level, which would support blended finance mechanisms or adequate tariff regulation.

The document therefore recommends the Ministry to elaborate the identified strategies in more detail, so that – taken together – they would allow financing the ambitious targets set in its 50/30 strategy.

Within MFA	Sector level in partner countries	Service provider or household level
<ul style="list-style-type: none"> <li>• Developing its own medium-term programming and expenditure framework</li> <li>• Establishing clear definitions and accounting rules for match funding</li> <li>• Ensuring as much as possible geographic and programmatic alignment between programmes aimed at capital investment in WASH and in strengthening (in)direct support</li> </ul>	<ul style="list-style-type: none"> <li>• Directing transfers and freeing up taxes towards the poorest populations</li> <li>• A measured use of blended finance</li> <li>• Supporting national tariff regulation</li> <li>• Support (partner) countries to develop financial strategies and plans</li> <li>• Contributing to a number of foundational issues in the enabling environment</li> </ul>	<ul style="list-style-type: none"> <li>• Using MFA funds (transfers) to promote self-supply where appropriate</li> <li>• Ensuring that service providers of water and sanitation systems set up with Dutch support apply an adequate tariff framework</li> <li>• Improving the operational and financial performance of service providers</li> </ul>

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## Annex 1: example of programming the 50/30 commitment

The calculations presented in this annex were supported by Azmeh Khan and Jacob Clemente.

### Programming scenarios

It is difficult to define in detail where the Netherlands will put all its effort in reaching the 50/30 commitment for a period of 15 years. There are existing programmes as well as ones that are already well advanced in the pipeline of formulation, appraisal and approval. It is to be expected that the majority of the target will be reached in the Netherlands' main partner countries. But this list of partner countries is regularly subject to review, depending on the country's development progress and changes in the relation between the Netherlands and that country. Also, the division of labour with other donors plays a role in this.

Given all these uncertainties, we therefore suggest a number of scenarios on how the Netherlands may go about programming where and how it is going to reach the 50/30 commitment.

We started by identifying a number of countries and the percentage and number of persons that currently do not have access to at least basic levels of drinking water or sanitation services. These are then considered the unserved (i.e. ones using surface water or practicing open defecation) and underserved (i.e. ones using unimproved or limited services). This was done for a long list of current and potential water partner countries, as defined and discussed in the most recent policy note 'Investing in Global Prospects'<sup>3</sup>. The reference data are taken for the year 2015, as the WASH strategy started in January 2016. It is noted that at the time of writing the Netherlands has already reached part of its commitment, but for the sake of this scenario analysis, we considered the entire 2016-2030 period. The results of that first step are presented in Table 2.

**TABLE 2. NUMBER OF PEOPLE (MILLION) WITHOUT AT LEAST A BASIC LEVEL OF ACCESS TO WATER SUPPLY OR SANITATION**

	Water supply			Sanitation		
	Urban	Rural	Total	Urban	Rural	Total
Afghanistan	1.0	11.1	12.0	3.8	16.0	19.8
Bangladesh	1.1	3.2	4.3	25.6	59.9	85.5
Benin	1.1	2.5	3.6	3.6	5.8	9.4
Ethiopia	4.4	56.1	60.5	15.8	76.6	92.4
Ghana	1.8	4.3	6.1	12.0	11.5	23.5
Indonesia	4.7	22.3	27.0	31.5	51.2	82.7
Iraq	2.6	2.4	5.0	3.6	1.6	5.2
Jordan	0.1	0.0	0.1	0.2	0.1	0.3
Kenya	2.0	17.2	19.2	7.6	24.7	32.3
Lebanon	nd	nd	0.5	nd	nd	0.3
Mali	0.6	3.9	4.5	3.8	8.3	12.1
Mozambique	1.9	12.9	14.8	4.8	16.6	21.4
Niger	0.4	10.4	10.8	2.1	15.2	17.3
Palestinian territories	0.5	0.1	0.6	0.2	0.0	0.2
Rwanda	0.8	4.3	5.1	1.4	2.9	4.3
South Sudan	0.9	5.2	6.1	1.7	9.4	11.1
Yemen	1.4	6.5	7.9	0.9	9.9	10.8
<b>Total</b>	<b>25.3</b>	<b>162.4</b>	<b>188.1</b>	<b>118.6</b>	<b>309.7</b>	<b>428.6</b>

<sup>3</sup> <https://www.government.nl/documents/policy-notes/2018/05/18/investing-in-global-prospects>

This shows that across these current and potential focus countries there are many more people living without access to drinking water and sanitation than the 30 and 50 million that are targeted for. It is also clear that most of these un- and underserved live in a few large countries; more than half of the unserved live in three countries: Ethiopia, Indonesia and Kenya (water)/Bangladesh (sanitation). There are several countries, particularly in the Middle East (Lebanon, Jordan and Palestinian Territories), that are home to relatively few un- and underserved. Finally, it must be noted that the largest number of unserved live in rural areas. For water 86% of the ones without basic access live in rural areas; for sanitation that is 72%.

This also means that there are several scenarios to 'distribute' the 50/30 target over these countries. We identified the following scenarios:

- Scenario 1: distribute the target proportionally to the number of un- and underserved living in these countries.
- Scenario 2: same as 1, but prioritizing countries that are home to more unserved, as compared to ones that are underserved.
- Scenario 3, but adding a number of political conditions: 1) the ending of the bilateral relation with Ghana and Indonesia by 2020, so having a relatively small target there, 2) the fact that new water partner countries (Niger, Ethiopia, Lebanon, Iraq and Jordan) would effectively only have fully fledged water programmes from 2019 at the earliest, 3) having a relatively small target for countries that are fragile or in civil conflict (Afghanistan, Iraq, Palestinian Territories, Mali, South Sudan and Yemen).
- Scenario 4, but assuming that 20% of the total target would be achieved in 'other countries', so outside the current partner countries, as there are many NGO, private sector and multilateral programmes operating outside the partner countries. Moreover, the Netherlands may establish new partner countries over the coming period.

Under all scenarios, programming should be done in such a way that 10% more than the 30/50 target would be reached, as a kind of buffer. So, in total 33 and 55 million would be programmed for.

The results of the scenarios are presented below:

**TABLE 3. NUMBER OF PEOPLE TO BE PROVIDED WITH WATER AND SANITATION SERVICES UNDER DIFFERENT SCENARIOS**

Scenario nr	Water supply				Sanitation			
	1	2	3	4	1	2	3	4
Afghanistan	2.2	2.3	1.6	1.3	2.6	2.9	1.9	1.6
Bangladesh	0.8	0.7	1.1	0.9	11.1	9.5	13.9	11.1
Benin	0.6	0.7	1.0	0.8	1.2	1.3	1.9	1.5
Ethiopia	10.9	10.3	10.8	8.6	12.0	14.7	14.8	11.8
Ghana	1.1	1.0	0.4	0.4	3.1	1.8	0.8	0.6
Indonesia	4.9	5.5	2.4	2.0	10.8	8.8	3.7	3.0
Iraq	0.9	0.7	0.4	0.3	0.7	0.4	0.2	0.1
Jordan	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Kenya	3.4	3.6	5.5	4.4	4.2	4.1	6.0	4.8
Lebanon	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Mali	0.8	0.9	0.6	0.5	1.6	1.5	1.0	0.8
Mozambique	2.7	2.7	4.1	3.3	2.8	3.5	5.0	4.0
Niger	1.9	2.1	2.2	1.7	2.3	2.7	2.7	2.2
Palestinian territories	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Rwanda	0.9	0.8	1.2	1.0	0.6	0.5	0.8	0.6
South Sudan	1.1	0.9	0.6	0.5	1.4	1.7	1.1	0.9
Yemen	1.4	1.1	0.8	0.6	1.4	1.7	1.1	0.9
Other countries				6.6				11.0
<b>Total</b>	<b>33.8</b>	<b>33.5</b>	<b>32.8</b>	<b>33.0</b>	<b>55.8</b>	<b>55.1</b>	<b>54.9</b>	<b>54.9</b>

The table shows that for most countries, there are no big differences in the number of people to be reached in the various scenarios. Each successive scenario only results in marginal changes in the number of people to be reached. For many of the countries, the various rules applied in each step balance out. The main exceptions to this rule are Ghana and Indonesia. The difference in the number of people to be reached in these countries between scenario 1 and 4 is very big, because for these two countries Dutch bilateral programmes would only run for a third of the time.

Though each of the scenarios is possible, we consider the fourth scenario the most realistic. Scenario 4 takes into account the various political considerations of scenario 3 and includes a sizeable percentage of people to be reached in other countries. That is realistic, as there are currently several multi-country programmes running in countries beyond the ones on the list. Moreover, the Netherlands provides a number of people with WASH services through the general contributions it makes to multilateral institutions. These institutions obviously work across the globe and fall under 'other countries'. Finally, there may be further changes in the list of partner countries in the future, and so part of the target would be reached there.

The graphs below are a visual presentation of how the target under scenario 4 would be distributed over the various partner countries.



FIGURE 2. DISTRIBUTION OF THE 30/50 TARGET OVER VARIOUS COUNTRIES FOR WATER SUPPLY (UPPER DIAGRAM) AND SANITATION (LOWER DIAGRAM) UNDER SCENARIO 4

These graphs show the distribution of the target over the various countries. Both for water supply and sanitation, more than half of the target would need to be reached in just five countries: Ethiopia, Kenya, Mozambique, Indonesia and Niger (water supply) or Bangladesh (sanitation). There are also several countries that – because of their small size, combined with high access levels – would barely contribute anything to the quantitative target (Jordan, Lebanon, Iraq and Palestinian Territories).

One can also look at these targets from the point of view of the recipient countries, by presenting them as percentages of the currently un- and underserved. For water supply, 33 million would be 18% of all un- and underserved in the focus countries. In Bangladesh, Benin, Kenya, Mozambique and Rwanda, the Netherlands could serve even more than 22% of the un- and underserved. It would make smaller contributions in the more fragile states or Indonesia and Ghana. For sanitation, a similar pattern is observed.

These graphs also show the implications for programming. On the one hand, the countries with existing programmes (Kenya, Mozambique, Indonesia, Bangladesh and to some extent Benin) could contribute a sizeable part of the target. So, from that perspective it is crucial that these programmes continue. But it also becomes clear that new programmes would need to start relatively quickly in the new countries such as Ethiopia and Niger. Only in that way, can the targets be met. Finally, it would also mean that if the bilateral programmes in Benin and Mozambique would be reduced after 2020 (as indicated in the new policy note), support to the water sector in other countries would need to be increased to reach the target.

It is also useful to look at the distribution of the target over rural and urban areas. Under scenario 4, 88% of the target for water supply could be reached in rural areas. For sanitation that would be 81%.







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