1C	
EFFICIENCY	**Principle 3. Financing**

Target group / Relevant stakeholder: National Policy-Makers, Municipal Governments, Regulators, Urban Water Utilities, Medium Water Utilities, Rural Service Providers, Watershed or River Basin Organisations, and/or Private Sector

DESCRIPTION

Ensure that governance arrangements help mobilise water finance and allocate financial resources in an efficient, transparent and timely manner (OECD, 2024, 36).

EXPECTED RESULTS

Outputs:

- Governance arrangements help water institutions across levels of government to raise the necessary revenues to meet their mandates, building through for example principles such as the polluter-pays and user-pays principles as well as payment for environmental services (OECD, 2024, 36).
- Sector reviews and strategic financial planning assess short-, medium- and long-term investment and operational needs and take measures to help ensure availability and sustainability of such finance (OECD, 2024, 36).
- Sound and transparent practices for budgeting and accounting provide a clear picture of water activities and any associated contingent liabilities including infrastructure investment, and aligning multi-annual strategic plans to annual budgets and medium-term priorities of governments (OECD, 2024, 36).
- Mechanisms foster the efficient and transparent allocation of water-related public funds (e.g., through social contracts, scorecards, and audits) (OECD, 2024, 36).
- Minimisation of unnecessary administrative burdens related to public expenditure while preserving fiduciary and fiscal safeguards (OECD, 2024, 36).

CONDITIONS FOR SUCCESS

- Four indicators are linked to higher budget execution rates in the water sector: Governance effectiveness, regulatory quality, state legitimacy, and the performance of political institutions (World Bank, 2024).
- For transparent, consistent, and sustainable water finance mobilisation (Pories et al., 2019), it is key that public and commercial funding is optimised for social objectives, implementing effective tariff-setting and economic regulations, enforcing performance standards with clear accountability, and defining mandates and obligations for service providers.
- Additional factors that facilitate financing include well-coordinated national water agencies and policies, efficient use of human capital, budget transparency and accountability, strong project planning, and a stable institutional and political environment (Denizer et al., 2013; Isham and Kaufmann, 1999 in World Bank, 2024).

BARRIERS

- Increasing water insecurity, driven by droughts, floods, and climate change, creates systemic risks for corporate and financial assets, jeopardising the economic sustainability of production, services, and real estate (Alaerts, 2019).
- Significant spending gaps remain for achieving SDGs 6.1 and 6.2, while the gap is smaller in irrigation (Joseph et al., 2024).
- The public sector dominates water spending (Joseph et al., 2024). Achieving SDGs targets requires a 2-4 times increase in financing for emerging markets and developing economies. While national budgets have expanded significantly, international development assistance has grown modestly. Commercial investment remains limited due to the high-risk nature of water projects and the weak creditworthiness of utilities and municipalities.

- Limited capacity restricts access to financing in many developing economies (Alaerts, 2019). Developing viable investment proposal remains a challenge, and the dominance of government-run institutions in the sector further complicates efforts to attract private funding (Kolker et al., 2016).
- Despite spending gaps, the water sector faces inefficiencies, executing only 28% of its allocated budget on average between 2009 and 2020 (Joseph et al., 2024).
- The water sector struggles with declining returns on public spending, which fell by 6% to 5% between 2009 and 2020. Inefficiencies cost water utilities USD 21.38 million annually (Joseph et al., 2024).
- Public spending on WASH services often benefits wealthier and urban communities. In addition, spending is capital intensive, with maintenance representing less than 7% of the total expenditures across sub-sectors (Joseph et al., 2024).

SOLUTIONS

- Enhanced governance effectiveness, regulatory quality, state legitimacy, and political institutional performance can improve budget execution (World Bank, 2024).
- Policy-makers prioritise spending, address SDG-related funding gaps, and balance synergies and trade-offs across water sub-sectors (World Bank, 2024).
- Strengthened Public Investment Management (PIM) can accelerate project implementation and improve absorptive capacity, reforming Public Financial Management (PFM) can ensure predictable, transparent, and timely fund allocation, and establishing realistic performance metrics can balance equity and efficiency in public entities (World Bank, 2024).
- Implementation of a credible regulatory system can support risk pooling and long-term investment, creating financial institutions to channel sustained funding into the water sector, and leveraging public and donor funds as guarantees to reduce investment risks (World Bank, 2024).
- Reforms of the water sector include promoting cost recovery and demand management through pricing strategies and behaviour change initiatives, strengthening institutional and human capacity to improve fund absorption, and enhancing data access, transparency, and communication to ensure accountability in service delivery (World Bank, 2024).

EXAMPLES

Integrating Environmental and Resource Costs into Water Tariffs in Italy's Brenta River Basin

SDGs linked

Water risks

The Parco Fiume Brenta project introduced an innovative approach to financing water and biodiversity conservation by incorporating Environmental and Resource Costs (ERC) into water tariffs (as foreseen by Article 9 of the EU Water Framework Directive) as a pilot mechanism in the Vicenza and Padova provinces, Italy. Led by Etifor and its partners, the initiative redefined the link between integrated water services and environmental protection, ensuring that water users contribute to sustainability efforts, including the conservation of a protected area from which groundwater is withdrawn. Before this project, ERC was neither classified nor included in Italian water tariffs. Through collaboration with the Italian Regulatory Authority for Energy, Networks and Environment (ARERA), a revised tariff system was developed, allocating small contributions from households to fund environmental initiatives, such as green infrastructure and nature-based solutions (NbS). This approach ensures long-term investment in water conservation and serves as a model for other contexts.

Linkages to Governance Principles

The project exemplifies financing in water governance by integrating ERC into tariff structures, securing funding for long-term conservation. The regulatory framework was strengthened through ARERA's revision of the national tariff method, ensuring compliance with EU principles like full cost recovery. Stakeholder engagement was key in securing buy-in from local actors, while managing trade-offs ensured a balance between economic feasibility and environmental protection. The circular economy principle was reinforced by reinvesting water tariff revenues into ecosystem restoration efforts.

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