



MCC-World Bank Group Collaboration in Mozambique Water & Sanitation Sector

I. Summary

In July 2005, the Government of Mozambique (GOM) submitted to the Millennium Challenge Corporation (MCC) a request for funding an ambitious conceptual proposal, comprised of an extensive program of urban and rural water/sanitation, roads, and private sector development in four Northern Provinces of Mozambique (Cabo Delgado, Nampula, Niassa, and Zambézia). In water/sanitation, this proposal sought to consolidate and advance the GOM's water sector strategy, which is based on private sector participation in service delivery. In particular, it contained a major focus on certain fundamental, yet largely neglected market segments, including small-town water supply and urban sanitation. However, those specific market segments presented major challenges in terms of sustainability, for which innovative solutions involving private sector participation were needed.

To assist the GOM in advancing the necessary program preparation work, MCC provided some initial pre-Compact grant funding to the GOM to help it conduct pre-feasibility studies and to carry out other crucial institutional and financial analyses. In so doing, MCC worked closely with the GOM to build off of its pioneering work begun in the mid-1990s and funded by the World Bank to put in place the essential sectoral institutions and regulatory frameworks to attract private-sector involvement in construction, operations, and maintenance of systems. The MCC-supported project preparation work eventually culminated in mid-2007 in a multi-donor funding package of US\$240 million that included US\$204 million from MCC¹, US\$15 million from the World Bank/International Development Association (IDA), US\$15 million from the Africa Catalytic Growth Fund (ACGF), and US\$6 million from the Global Partnership on Output-based Aid (GPOBA).

This multi-donor collaboration is an excellent example of donor coordination. It advances the goals of the Paris Declaration; provides a useful platform for ongoing coordination and alignment between Government and its development partners; and should facilitate the scaling-up of future aid to the sector. The US\$240 million multi-donor investment program represents an important step toward implementing the commitments made at the 2003 G8 Summit in Evian, France, embodied in a plan entitled "Water: A G8 Action Plan." This plan commits the G8 to assist in the efforts to provide safe drinking water and sanitation to the world's poor, while helping to mobilize domestic resources in developing countries for water infrastructure financing through the development and

¹ MCC's US\$204 million water/sanitation investments are part of a larger five-year, US\$507 million Compact, signed in July 2007, which also includes funding for roads, land administration, and agriculture.

strengthening of local capital markets. In addition, MCC's US\$204 million investment constitutes a major deliverable under the Water for the Poor Act.

The initial stage of implementing of the multi-donor funding package is already underway, and began with the key institutional and policy reforms. These will be followed by large-scale civil works, which will increase access to safe, reliable water supply and sanitation services. These investments are expected to reach more than two million people, particularly women and girls, who can spend hours every day fetching water, thereby leaving them more time for income-earning opportunities and to attend school. They will also help reduce water-borne diseases, one of the leading causes of death in children under five.

II. Background

Since emerging in 1992 from nearly three decades of devastating conflict, Mozambique has experienced one of the fastest growth rates in Africa, averaging 8 percent per year over the last decade. Nevertheless, half of Mozambique's population of 20 million people still lives in poverty. Given the country's rapid urbanization, its next stage of economic recovery cannot succeed without well-functioning public services in its cities, where coverage levels for key services such as water and sanitation are declining. Ranked at 168 out of 176 countries on the Human Development Index, Mozambique has recognized that poor access to water and sanitation is a major barrier to growth and health. Indeed, Mozambique has one of the lowest levels of water consumption in the world. With an average of less than 10 liters per capita per day, the country is far below global benchmarks, including those for Africa. As a result, the Government has identified water/sanitation as a major policy priority in its poverty reduction and growth strategy. Together, these factors provided the underpinning for the Government's proposal for MCC support.

III. Proposal to MCC

The GOM's wide-ranging proposal to MCC in July 2005 included a request for support for:

- ★ Rehabilitation and expansion of 23 urban water supply systems;
- ★ Seven urban sanitation systems;
- ★ 1,500 rural water points;
- ★ Bulk water supply and transmission improvements;
- ★ Capacity building of private sector, municipality, district and provincial institutions; and
- ★ Policy reform and institutional development.

However, the proposal to MCC was conceptual in nature because of scant existing project preparation work. Therefore, to help the GOM conduct pre-feasibility studies to narrow the scope and to assist in identifying the

components of a viable water/sanitation program that MCC would meet MCC’s investment criteria,² MCC provided some initial pre-Compact grant funding to the GOM totaling US\$4.9 million.³

IV. Multi-donor Collaborative Mechanism

The GOM’s proposal to MCC sought to address some key neglected market segments—small-town water supply and sanitation—thus helping to consolidate and advance the GOM’s water sector strategy. Based on a system of delegated management, this strategy⁴ seeks to involve private sector participation to reduce operating costs and improve service—factors that are key to sustainability. However, the particular market segments proposed to MCC presented major challenges in terms of sustainable service delivery.

Therefore, to attend to the GOM’s request, MCC formed a strategic partnership with the World Bank and other donors—designed to leverage their respective institutional comparative advantages—to put in place creative, sustainable service delivery solutions designed to benefit potentially millions of people throughout Mozambique. A focal point of the partnership was to merge the MCC’s large amount of potential grant funding in the form of a Compact—which is particularly well suited for capital investments—with the Bank’s institutional and policy knowledge and its resource mobilization network. Annex 1 contains details of how the institutional collaboration came about at the operational level.

From MCC’s perspective, the World Bank’s resources, experience, and knowledge were instrumental in: (1) helping to bring about the institutional and policy reforms necessary for Mozambique to succeed in its objectives for sustainable water supply; and (2) providing the GOM with support to help organize and deepen its inchoate sector-wide approach (SWAp) in the rural water sub-sector. In addition, MCC recognized that the World Bank was well positioned to structure potential solutions for operations and management (O&M) support, as well as to mobilize other donors that could provide complementary support for distribution solutions and system connections, including investing in areas beyond MCC’s geographic focus on the Northern Provinces. Accordingly, the World Bank support was crucial to enhancing the overall sustainability and potential for success of the MCC-supported investments.

From the perspective of the World Bank, this institutional collaboration represented a timely opportunity to help catalyze transformational change in the water/sanitation sector in Mozambique, and to consolidate the institutional achievements begun under its previous operations by extending the reach of the delegated management framework. In turn, the Africa Catalytic Growth Fund—a trust fund administered by the World Bank—helped to “crowd-in” other donors in order to scale-up the existing IDA water/sanitation portfolio, especially the innovative service-delivery models piloted under its National Water Development Projects #1 and 2, beginning in the 1990s.

² MCC’s investment criteria include economic, financial, institutional, and environmental sustainability; technical feasibility; and executability within a five-year period.

³ This was part of a larger US\$13.5 million grant conferred in September 2005 to assist with overall program development—including areas such as road infrastructure and private sector development—based on the proposal submitted by the GOM to MCC.

⁴ In urban water supply, the strategy is predicated on a separation of asset ownership and operations and maintenance (O&M). Under delegated management, the state owns the water assets; O&M is carried out by the private sector; and an independent regulatory authority sets service standards and regulates tariffs.

By facilitating a potentially large parallel investment by MCC of grant funds, this collaborative initiative represented a unique opportunity to:

- ★ Overcome scale/scope issues surrounding the challenging economics of distributed water in small towns;
- ★ Provide sanitation services to small towns and expand such coverage for large cities; and
- ★ Push forward a program-based approach for the water/sanitation sector, including providing support to move the rural sub-sector SWAp to the next stage operationally.

V. Objectives of the Multi-donor Investment Program

A central objective of the multi-donor program is to deepen private participation in the sector and to broaden the delegated management framework to cover small cities and towns and sanitation. Currently, more than a dozen cities in Mozambique are served by private sector operators through various modalities under the existing delegated management model. Under contract with a state-owned asset-holding company called the Water Supply Investment Fund (FIPAG), which was piloted under the World Bank-funded National Water Development #2 Project, a private international company operates Maputo under a 12-year lease agreement, and also operates Beira, Quelimane, Pemba, and Nampula under a separate management contract. These four cities are moving to lease contracts in the near future. In the south of Mozambique, four smaller cities are packaged together and served by another international private operator.

Under the multi-donor program, a similar approach will be rolled out in the areas of MCC's geographic focus. A new asset holding entity—called the Asset Management Unit (AMU), organized under the GOM's National Water Agency (DNA)—will be established to serve smaller urban areas, and will cover five cities initially. Modeled generally on FIPAG, the idea is to pool the assets of enough cities in order to achieve sufficient scale to attract the interest of private operators. Whereas FIPAG is only responsible for water supply, AMU will have responsibility for both water/sanitation. Moreover, AMU will not own the assets, while FIPAG does.

The collaborative multi-donor investment program supports the GOM's long-term financial goals for the urban and town water sector by:

- ★ Providing funds to FIPAG for its investments in four Northern cities that will lead to an expanded customer base and increased revenue;
- ★ Providing institutional, technical, and short-term O&M support to the AMU until it is able to cover its O&M costs through user tariffs;
- ★ Creating Provincial Water Boards (PWB) to ensure demand-responsive service solutions and improved voice/accountability for local stakeholders; and
- ★ Supporting the independent Water Regulatory Commission (CRA) to expand its areas for regulation to include the AMU areas.

As an innovative pilot, the AMU will facilitate the execution of investments and engage third-party operators under delegated management contracts to supply water services in small cities and towns and sanitation services more generally. In the context of decentralization and de-concentration efforts by the GOM, the AMU will convene PWBs, which will be the responsible contracting parties for O&M services under the AMU. The governance structure of the PWBs was designed to ensure demand-responsive service-delivery solutions. Accordingly, the PWBs will have Boards of Directors composed of representatives of provincial, district, and municipal governments.

As for regulatory matters, CRA, the independent regulator, oversees the water supply services under the delegated management structure in Mozambique. Its functional mandate under the extant legislation is broad—to protect consumers, regulate service quality, approve changes in tariffs, and promote and improve the delegated management framework—but it did not cover the provision of sanitation or wastewater. Fortunately, CRA had already done considerable analysis on what was needed to expand the scope of its operations to deal with future water sector reforms and system development. CRA's objective was to develop a regulatory structure that devolves much of the day-to-day data gathering, reporting, and oversight of the sector to the local level—a sort of “franchise regulation.”

In terms of sanitation, CRA did not have the authority to regulate user fees for sanitation and services. However, through the multi-donor funding program, the process for granting that authority has already begun under the auspices of the US\$15 million Water Services and Institutional Support Project (WASIS) funded by the World Bank/IDA. In addition, because water supply and sanitation are very closely linked and because there is typically a much higher willingness to pay for water than for sanitation, FIPAG agreed to: (i) provide consumers with a unified water and sanitation bill; and (ii) collect sanitation fees and remit them to the AMU at reasonable cost.

One of the main goals underpinning the successful policy of the GOM's delegated management framework is to achieve sustainability by improving the financial viability and efficiency of the service providers in the urban and town water sector. Achieving long-term financial sustainability entails reducing the dependence on government subsidies and increasing reliance on tariffs from the customers as the main source of internally generated financing. To this end, the multi-donor funding package will help develop and consolidate key sectoral institutions such as FIPAG and AMU by extending and deepening the delegated management program, and to assist in the overall development of the sector. In the process, it is expected that the multi-donor funding package will help move the existing management contracts to leases, while expanding the scope of private participation to urban areas currently operated by state-owned or municipally-owned service providers, as seen in the table below. This should improve service quality and the prospects for system sustainability. Moreover, through this process, the existing service providers are expected to gain financial autonomy to tap other sources of funding from international and domestic financiers and the capital markets.

Comparison of Service Delivery Mechanisms Before and After the New Multi-donor Funding Program

Large cities	Existing Service Model	Future service model
<ul style="list-style-type: none"> ★ Beira ★ Nampula ★ Pemba ★ Quelimane 	Private sector management contract	Lease
Smaller cities/towns	Existing Service Model	Future service model
<ul style="list-style-type: none"> ★ Nacala ★ Mocuba ★ Gurué ★ Monapo ★ Montepuez 	Public water company	Private sector management contract

VI. Description of the Multi-donor Investment Plan

A. Funding from MCC involves:

- ★ Water supply and sanitation services in three large cities (Nampula, Pemba, and Quelimane) and five mid-sized towns (Nacala, Mocuba, Gurué, Monapo, and Montepuez) in the provinces of Zambézia, Nampula and Cabo Delgado;
- ★ Rural water supply services covering 600 villages in the Nampula and Cabo Delgado provinces; and
- ★ Capacity building of local institutions and policy development.

The water supply interventions are designed to increase system capacity by improving raw water intakes, transmission systems, treatment works, distribution and storage systems, and household connections. To complement the enhanced water supply, the MCC investments will also improve sanitation systems by: expanding wastewater treatment; improving the piped sewage network; and increasing the usage of septic systems in urban centers and latrines in peri-urban areas. In addition, storm drains will be rehabilitated and expanded to improve drainage efficiency.

B. Funding from the **World Bank, ACGF, GPOBA** includes the following three components, and will cover geographic areas that are beyond MCC's scope:

- ★ Investments and continuing support in four cities under the existing responsibility of FIPAG (Beira, Nampula, Pemba, and Quelimane): The project will support an improvement of water supply access from the construction of approximate 370 kilometers of network resulting in 10,000 new connections in

four cities. In addition, 20,000 additional connections are being supported through the GPOBA scheme for low-income neighborhoods.

- ★ Capacity building, institutional and operational support to the National Water Agency: The project will establish and operationalize the AMU and PWBs. Under this component, the project will also support the preparation of the SWAp for the rural water sub-sector.
- ★ Operational support to CRA with respect to expanded regulatory responsibility for smaller towns and cities: The project will support the development of regulatory frameworks to cover the smaller towns and cities as AMU is set-up and expanded via the PWBs.

Investment activities include: the rehabilitation of water production, transmission, storage and distribution facilities and wastewater collection, treatment and disposal facilities; the expansion of water supply and sewerage services; and the strengthening of the institutional structures for water and sanitation service provision, emphasizing increasing institutional accountability and transparency of PWBs and water services providers.

VII. Best Practices/Lessons Learned

This collaboration represents a “best practice” example of donor coordination. It capitalizes on the comparative advantages of each institution, and incorporates lessons learned by building off of successful, previous interventions to support the GOM’s sector reform agenda. As a result, the collaboration produced an efficient financial structure by harmonizing the sources and uses⁵ of the parallel funding from different donors. Consistent with the Paris Declaration, MCC and the World Bank coordinated closely to align their efforts with the GOM’s objectives and priorities. Throughout the ongoing project preparation process, there was also extensive coordination in-country with other water sector donors. Their input and country knowledge were particularly helpful to MCC and GOM in assembling the terms of reference for the initial project preparation work funded by the MCC pre-Compact grant to advance the GOM’s proposal beyond the conceptual stage. During the project preparation phase, this collaboration involved the MCC’s and the World Bank’s conducting a joint appraisal and agreeing to carry out future joint supervision missions. Indeed, during their respective program preparation and appraisal phases, both MCC and the World Bank ensured continuity by using the same consultants for the crucial institutional development and financial sustainability studies.

VIII. Next Steps

In terms of progress to date, the Government, supported by MCC and the World Bank, is beginning to advance on the key institutional developments and policy reforms, including defining: (i) the operational arrangements and organization structure for the AMU; (ii) the key legal and regulatory arrangements within Mozambique, including CRA, other water sector institutions, and different levels of government; (iii) modalities of coordination between

⁵ Borrowing a project finance concept, the efficient financial structure refers to a calibrated, coordinated program-level process by which the different donors arrived at funding decisions for the assorted elements of the overall investment program, based on a variety of considerations, including differing investment horizons, funding availability, and sequencing of interventions.

the municipalities and AMU; and (iv) a financial business model for the AMU. These will be followed by civil works during the MCC Compact's five-year program execution period. The expected outcome of this multi-donor investment program should be: to greatly strengthen the country's key existing water/sanitation institutions; to create new sector institutions; and to put in place the mechanisms for greater system sustainability by deepening private sector participation in service provision. It is expected that this collaboration will provide a useful platform for ongoing coordination and alignment between Government and its development partners, and should facilitate the scaling-up of future aid to the sector.

Annex 1

Operationalizing the Institutional Collaboration

At the technical staff level, this institutional collaboration between MCC and World Bank grew out of a previous positive experience of joint staff work on Cape Verde. To begin tackling the GOM's proposal, MCC used the World Bank's existing economic and sector work and other operational work products to ensure that any MCC-funded investments were aligned with Mozambique's water sector strategy and harmonized with other donor efforts. An important and particularly useful starting point was a February 2004 report called "Millennium Development Goals for Water and Sanitation: Country Assessment—Mozambique." MCC also benefited from the input of staff from the World Bank's Water and Sanitation Program as well as its operations staff responsible for water/sanitation and municipal development, starting in March 2005 and continuing throughout the program development phase.

In October 2005, MCC participated in the World Bank's Mozambique Country Team operational offsite retreat. Following this, MCC suggested the possibility of preparing a parallel funding operation in January 2006. This, in turn, triggered discussions around a possible role for the Africa Catalytic Growth Fund. Throughout the first half of 2006, World Bank staff—with input from MCC—worked on creating the conditions to modify the World Bank's existing Country Assistance Strategy (CAS) in order to include a new IDA water sector support operation. To facilitate such a result, the institutional collaboration between MCC and the World Bank intensified during July 2006. These efforts resulted in the Bank's preparing a Project Concept Note in December 2006 for a new IDA re-peater investment operation called the Water Services and Institutional Support Project (WASIS), for which MCC participated in the peer review process.

This example of multi-agency donor collaboration represents a deliverable under the World Bank's Africa Action Plan (AAP), which focuses on achieving the MDGs through sustainable service expansion and partnership. Indeed, a central tenet of the ACGF is that it represents an important channel for implementation of scaled-up assistance under the AAP. One of the major objectives of the AAP is "meeting the infrastructure gap" to support growth, not only for capital requirements but also for operations and maintenance. The AAP Flagship for Water Supply and Sanitation emphasizes the achievement of the MDGs by focusing on strengthening the public sector's ability to manage expanding sector programs and the private sector's role in providing the goods, works and services. Such donor collaboration also represents a deliverable under the Communiqué of the World Bank/IMF Development Committee, insofar as it illustrates an example of filling institutional gaps, and cooperating with other financial institutions. Moreover, this collaboration provided an opportunity to facilitate entrepreneurial approaches internally by allowing for flexible, client-driven solutions, given that the WASIS Project was not part of the original CAS for Mozambique.

