RiPPLE

Financing in the water, sanitation and hygiene (WaSH) sector in Ethiopia:

Evidence from Benishangul-Gumuz regional state

May 2009

Synthesis Paper

Research-inspired Policy and Practice Learning in Ethiopia and the Nile region

Financing in the water, sanitation and hygiene (WaSH) sector in Ethiopia: Evidence from Benishangul-Gumuz regional state

Getnet Alemu and David Thomas

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Research-inspired Policy and Practice Learning in Ethiopia and the Nile region (RiPPLE) is a five-year research programme consortium funded by the UK's Department for International Development (DFID). It aims to advance evidence-based learning on water supply and sanitation (WSS) focusing specifically on issues of planning, financing, delivery and sustainability and the links between sector improvements and pro-poor economic growth. The opinions expressed are those of the authors and not of DFID.

RIPPLE Synthesis Papers take forward case study findings from a RiPPLE research theme, by providing further analysis and offering sound policy recommendations.

RiPPLE Office, c/o WaterAid Ethiopia, Kirkos Sub-city, Kebele 04, House no 620, Debrezeit Road, PO Box 4812, Addis Ababa, Ethiopia.

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This paper is a synthesis of the case studies carried out in the Benishangul-Gumuz region (BG) of Ethiopia by the RiPPLE Financing team, composed of:

- **Tseguereda Abraham**, Policy Officer WaterAid Ethiopia,
- **Getnet Alemu**, Associate Dean for Graduate Programs, College of Development Studies, Addis Ababa University and
- **Catarina Fonseca**, Senior Programme Officer, International Water & Sanitation Centre (IRC).

The paper analyses and summarises the findings of the research done by the following researchers and their organisations:

- **Minilik Wube**, **Epherem Alemu** and **Dereje Ademe**, Bureau of Water Resources, Benishangul-Gumuz Region
- **Girmaw Nemera** and **Mulatu Takele**, Bureau of Finance and Economic Development, Beinshangul-Gumuz Region
- **Ayana Zewdie,** Regional Administrative Council
- **Abera Endeshaw**, RiPPLE

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Note about dates in this document

Ethiopia uses the Ge'ez calendar which is about seven years and nine months behind the Gregorian calendar used in much of the world. Some of the data and dates used in this document were based on the Ethiopian calendar. Dates have been converted to the Gregorian calendar for the purposes of this international document. However, because the Ethiopian New Year begins in September, an annual figure from the Ethiopian calendar does not exactly match any exact Gregorian calendar year.

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Acronyms

BoFED	Bureau of Finance and Economic Development
BoWR	Bureau of Water Resources
DAC	Development Assistance Committee (OECD)
DFID	UK Department for International Development
EC	Ethiopian Calendar; runs from September to September.
	Year 2000 EC corresponds with 2007/2008 Gregorian Calendar
EFY	Ethiopian Fiscal Year
EWSSP	Ethiopian Water Supply and Sanitation Project
EUWI	European Union Water Initiative
GDP	Gross Domestic Product
GNI	Gross National Income
IDA	International Development Association
M&E	Monitoring and Evaluation

MDG	Millennium Development Goal
MoFED	Ministry of Finance and Economic Development
MoU	Memorandum of Understanding
MoWR	Ministry of Water Resources
NGO	Non-governmental Organisation
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PASDEP	Plan for Accelerated and Sustained Development to End Poverty
PRS	Poverty Reduction Strategy
RiPPLE	Research-inspired Policy and Practice Learning in Ethiopia and the Nile Region
UAP	Universal Access Plan (WSS)
UN	United Nations
UNICEF	UN Children's Fund
VAT	Value-added Tax
WASH	Water, Sanitation and Hygiene
WRDF	Water Resources Development Fund
WSS	Water Supply and Sanitation

Executive Summary

The scaling-up of financial resources and management in water, sanitation and hygiene (WASH) is part of an effort to achieve the Millennium Development Goals (MDGs). However, putting additional resources into the sector is only a starting point: it is crucial to ensure that money is spent effectively.

The Research-inspired Policy and Practice Learning in Ethiopia and the Nile Region (RiPPLE) programme has Finance as one of its research themes. The Finance theme hypothesis is that improving equitable access to WASH for the poor is contingent on effective organisation of financing arrangements. This paper reviews the financing of the WASH sector in Ethiopia and then goes on to look at two specific financing channels, using case study information from Benishangul-Gumuz regional state.

Financing and the WASH sector in Ethiopia

In terms of internal funding, regional governments are financed through federal grants, federal–regional shared revenue and regions' own revenues. Additionally, woredas are financed by block grants from regional governments and their own revenues (generated through user fees and community contributions to capital investments in the form of in-kind and cash contributions).

Meanwhile, donor funding to Ethiopia is generally categorised into three 'channels':

1. Channel 1 is 'on-budget', managed by the federal Ministry of Finance and Economic Development (MoFED), regional Bureaus of Finance and Economic Development (BoFEDs) and woreda Finance Offices;
2. Channel 2 funds are made available directly to sector ministries such as the Ministry of Water Resources (MoWR), allocated down to regional bureaus such as the Bureaus of Water Resources (BoWRs), and from there channelled to woreda sector offices such as Water Offices;
3. Channel 3 resources are transferred directly to those responsible for implementation, but not through MoFED or BoFED, and are often entirely 'off-budget'.

Water and sanitation have declined as a share of total poor-focused expenditure in Ethiopia's Plan for Accelerated and Sustained Development to End Poverty (PASDEP) (2005/06 to 2009/10), from 7.4% in 2005/06 to 3.4% in 2009/10. In addition, actual expenditure may fall well short of these levels. It seems that a very significant proportion of resources are not utilised and are subject to bottlenecks.

The level of public resources available is set nationally, within a medium-term expenditure framework linked to the PASDEP. The dominant national sector policy is the Universal Access Plan (UAP). In practice, the federal system makes it impossible to predetermine with any precision the levels of funding to services delivered by regional and local government. Proportions allocated to different sectors depend on decentralised governments' priorities; discretion over the allocation of block grants to sectors is limited by existing commitments, capacity and staffing levels.

In past years, aid flows to the WASH sector have largely used Channels 2 and 3. This is currently changing, as donors and government make efforts to strengthen a programmatic approach and ensure the alignment of financing mechanisms. However a large number of off-budget projects remain and even where financing is provided through the budget, conditions and reporting procedures tend to be excessively onerous.

Budget transparency and accountability in Ethiopia are limited, although efforts are being made to institute an open budget system at all levels of government. The government, particularly at lower tiers, does not currently recognise citizens' rights to information about allocations.

The UAP is based on national-level unit costs for service provision and fails to take regional differences into account. Costs also do not include operation and maintenance, capital maintenance and direct and indirect support costs, meaning that existing systems have limited chances of being sustainable. Other financial costings not considered include management resources for schemes require higher level of skills (including at management and oversight level) and the involvement of authorities in monitoring and evaluation (M&E). A further problem is that the community management service delivery approach, seen as the solution to WASH problems in rural areas, has bypassed local government authorities and reduced their ownership; however these actors are still needed if rural services are to be sustainable and scalable.

Channel 1 financing: Benishangul-Gumuz region

There is evidence of an inability to utilise Channel 1 funding efficiently and effectively. This raises questions as to the wisdom of allocating additional resources using these funding channels before bottlenecks are addressed. In Benishangul-Gumuz, as in Ethiopia as a whole, the budget to water has been very low compared with other basic service sectors. At the same time there has been under-spending of the Channel 1 water budget in the woredas. There are problems with lack of coordination and structural clarity in the sector; lack of consistent and well-organised data; delays in financial disbursements; lack of effective and systematic M&E; and prevalence of centralised budget allocation at woreda level.

Suggestions for improved allocation of the Channel 1 water budget are as follows:

- Capacity building for budget decision makers at regional and woreda levels on relevant policies.
- Oversight of budget allocations should be enhanced at all levels.
- Mechanisms should be put in place to ensure that allocations are based on local needs and priorities.

Suggestions for efficient utilisation of the Channel 1 water budget include the following:

- Improvements in the ways budget information is accounted, audited, monitored and presented.
- Greater autonomy over allocated resources should be accompanied by results-oriented arrangements such as sound rules, regulations and working procedures.
- Sectors and line agencies should develop strategic plans as inputs to the overall water sector strategy to ensure that delays at regional level do not occur. In addition, desk/bureau heads should be held accountable for adherence to spending limits and budgets should be linked to performance targets that can be related to poverty reduction and efficiency goals.
- Roles and responsibilities in the sector should be clarified.
- Strengthening of woreda institutions for more effective resource planning.

- Information and M&E systems need to be improved (especially with regard to budgets), to ensure thorough assessment of not only the adequacy of budgets but also the efficiency and effectiveness with which expenditures are being made.

Matching funds/Channel 2 financing

Allocation and utilisation of matching funds by government are conditions for accessing donor funding for the World Bank's Ethiopian Water Supply and Sanitation Project (EWSSP). The EWSSP is negotiated at federal level and donor funds flow directly from MoWR to BoWR through Channel 2. The region is supposed to cover 15% of the costs in the form of matching funds, but Benishangul-Gumuz has been unable to hold and utilise the 15% matching funds for which it is responsible.

In Benishangul-Gumuz, understanding of the conditions and guidelines for matching funds was not clear. A lack of common approaches to matching funds in the international community has contributed to this problem. At the same time, the coexistence of different internal mechanisms for funding to the water sector has been problematic. Matching funds are not generated or passed on by BoFED, because of poor communication and bureaucratic confusions between Channel 1 financing (matching funds and regional block grants) and Channel 2 financing (EWSSP funds). The Benishangul-Gumuz BoFED is not officially aware of the programme: the flow of funds through Channel 2 means that BoFED does not have a comprehensive picture of the total amount of financial resources flowing to the sector.

Meanwhile, many woredas have found it difficult to allocate funds because of low financial capacity and competing demands by all sectors. As a result, no evidence of actual transfer of money as matching funds was observed in the study area. Moreover, because of the limited financial capacity of communities, collection of cash contributions has been difficult and the tax base is limited. As the amount of revenue collected at each level is taken into consideration when allocating block grants to woredas, the fact that actual collection by woredas is usually much lower than planned creates a problem in allocating a budget for matching funds.

WASH implementation structures and guidelines have recently been set up, along with the harmonisation of financing channels. However, poor integration and communication between sector bureaus and woredas have contributed to the failure to allocate and the ultimate under-spending of donor funds.

Hidden costs such as bank service charges, running costs of offices and import tax for vehicles are a further challenge: these may not be taken into consideration in budget planning and when signing matching fund agreements with donors. Finally, differences between fiscal calendars create problems for budget allocation and M&E. Different calendars mean different requirements and disbursement schedules; different reporting timeframes and auditing; and inefficient use of resources.

The following recommendations for future actions have been identified:

- Communities should have the option of paying in-kind. Overhead costs should be considered matching funds on the part of the local government.
- To improve communication and integration, the memoranda of understanding between sector bureaus and woredas should be fully implemented. A tripartite agreement between BoFED, BoWR and the woreda Water Office should be established, with strong periodical joint M&E.

- The government of Ethiopia should clearly inform MoFED, and MoFED should inform its regional bureaus, about any agreements made with donors. Regions should be given the opportunity to comment on negotiation and its content.
- Capacity to allocate matching funds is a problem in all regions. The economic level of the people and the government should be given due consideration.
- A mechanism should be put in place by the federal government to help less populated regions fill the gap arising from the budget deficit.

Implications for policy and planning in Ethiopia

- Donor and NGO support for any sector must be coordinated and targeted at increasing the capacity of the government to continue to implement programmes and projects.
- All agencies and partners that require matching funds should use a common approach, with similar rules, ratios and delivery methods.
- The establishment of longer-term allocations alongside training in budgeting and spending, may offer a way to break out of the vicious cycle of erratic allocation of funds and their poor utilisation in the WASH sector.

The government has committed a great deal of effort and resources to the WASH sector, as is illustrated by its prominence in numerous poverty reduction papers and strategies. However, these verbal and written commitments need to be further supported with large contributions of government resources which meet the proportions suggested in the PASDEP.

1 Introduction

The scaling-up of financial resources and management in the water, sanitation and hygiene (WASH) sector is part of an effort to achieve the Millennium Development Goals (MDGs). This area became a key development theme post-Monterrey, and with the UN's Millennium Project Task Force report on Water and Sanitation (2005). Putting additional resources into the sector is only a starting point in a country such as Ethiopia: it is also crucial to ensure that money is spent effectively.[1]

In a country such as Ethiopia, which had a gross national income (GNI) per capita of US$100 in 2002 – a quarter of the sub-Saharan African average (World Bank, 2004a) – and which still has some 28 million people living below the poverty line and another 10% who are chronically poor and destitute, establishing effective sector financing is a hugely important task.

The RiPPLE finance theme hypothesis is that improving equitable access to WASH for the poor is contingent on effective organisation of financing arrangements. Research questions under this hypothesis include:

1. What forms of investment in water supply and sanitation (WSS) are most effective in promoting poverty reduction, equity and pro-poor economic growth in different socioeconomic contexts?
2. What are the best mechanisms for delivering finance?
3. How can planning, budgeting and financing function more effectively under highly decentralised structures?
4. How can sector coordination, performance monitoring and donor harmonisation be improved?
5. How can performance monitoring and evaluation (M&E) at local levels be improved?

In Ethiopia, there are several and varied external sources of funding. Ethiopia is one of the most aid-dependent countries in the world (around US$1.9 billion per year), and one of the largest per capita recipients of emergency aid. However, it is also one of the lowest per capita recipients of development aid in Africa.

The role of the RiPPLE programme goes beyond collecting, analysing and sharing cases of selected woredas and monitoring progress and changes over the period of RiPPLE's Long-term Action Research Studies (LARS), to pilot ways in which information flows from the woreda to the regional and federal level and vice versa for increased accountability in the sector.

[1] See WaterAid (undated), which states that actual spend has been just 30% of the available budget.

2 Financing and the WASH Sector in Ethiopia

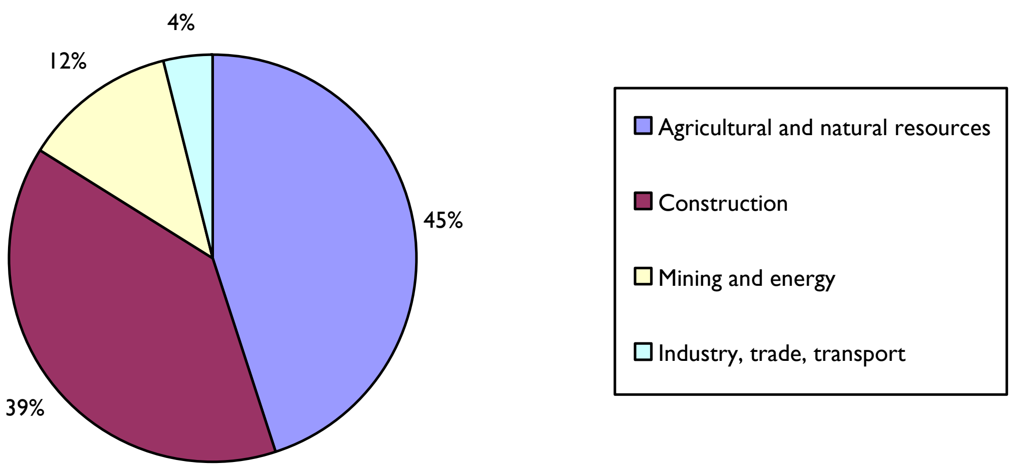
2.1 Poverty reduction and water policy in Ethiopia

The government recently prepared its Plan for Accelerated and Sustained Development to End Poverty (PASDEP) (MoFED, 2006) for the five-year period from 2005/06 to 2009/10 (Ethiopian Fiscal Year (EFY) 1998-2002). The document is supposed to encompass: i) the development path that the government will follow in the next five years; ii) the specific objectives to be achieved at the end of the programme period; and iii) the instrument of policy that will be employed and the indicators by which achievements are to be measured (EEA/EEPRI, 2007).

The link between the overall budget and the PASDEP is carried out by means of a macroeconomic and fiscal framework. The overall budget is divided into four major expenditure categories, namely, Administration and General Services; Economic Services; Social Services; and Other Expenditures. Out of total federal government expenditure, the shares of the four major expenditure categories in EFY 1999 (2006/07) were 13.2%, 31.6%, 16.8% and 38%, respectively (EEA/EEPRI, 2007).

Each of the expenditure categories includes sectoral spending. For instance, the second expenditure category, Economic Services, includes spending on agriculture and natural resources; water resources; industry and trade; mining and energy; transport and communication; and construction activities. Figure 2.1 illustrates how the Economic Services budget is divided.

Figure 2.1: Respective shares of the budget allocation for Economic Services



Source: Taken from EEA/EPRI 2007

Of the total budget to all four major budget categories, more than 70% has been allocated to government-defined 'pro-poor sectors' in the PASDEP period. The aggregate share of these pro-poor sectors in EFY 1999 (2006/07) was around 72.2%. Of the major pro-poor sectors, the share of education was 15.3%; agriculture and rural development 7.4%; roads 11.8%; health and HIV/AIDS 6.2%; and water and sanitation (the lowest), 6.5% (EEA/EEPRI, 2007). It should be noted that the above are indicative spending shares, not the proportions actually allocated to the sectors. The goals for the PASDEP water and sanitation sector strategy (drinking water and sanitation) are:

- To provide access to all population to clean potable water over the coming seven years;
- To build capacity at different levels, particularly at sub-national level, where actual implementation is taking place;
- To focus on low-cost, affordable and labour-intensive technologies;
- To improve sanitation outcomes;
- To focus on gender considerations while designing projects and programmes; and
- To provide high participation opportunities for females to benefit from construction work.

In order to achieve these sectoral targets, a number of inputs are required. These range from good policies to financial, human and material resources.

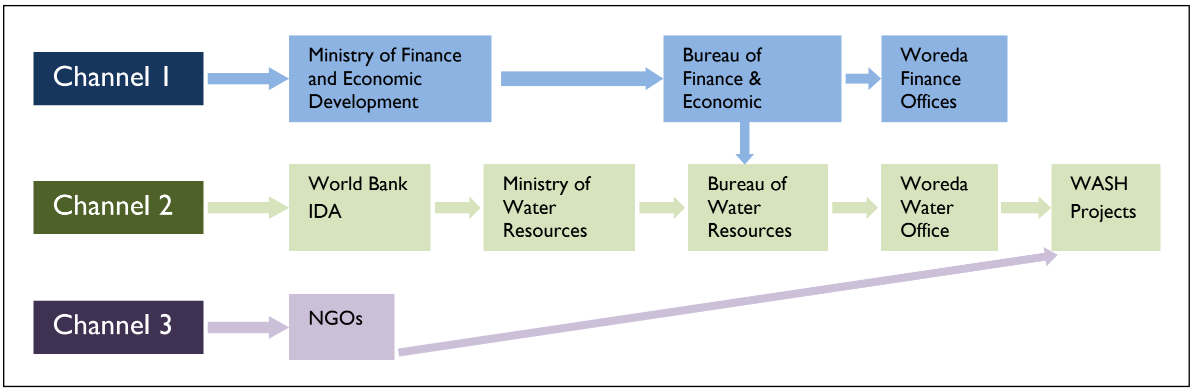
2.2 Aid modalities for the WASH sector in Ethiopia

In terms of government of Ethiopia internal funding, regional governments are financed through federal grants, federal–regional shared revenue and regions' own revenues. Additionally, since 2002, woredas are financed by block grants from regional governments and their own revenues. A specific purposive grant for physical infrastructure, called the Local Investment Grant, is currently under consideration (Thomson, 2007).

Donor funding to Ethiopia is generally categorised into three 'channels':

1. Channel 1 is 'on-budget' and 'on-treasury' and is managed by the federal Ministry of Finance and Economic Development (MoFED), regional Bureaus of Finance and Economic Development (BoFEDs) and woreda Finance Offices;
2. Channel 2 funds are made available directly to sector ministries such as the Ministry of Water Resources (MoWR), allocated down to regional bureaus such as the Bureaus of Water Resources (BoWRs), and from there channelled down to woreda sector offices such as Water Offices; and
3. Channel 3 resources are transferred directly to those responsible for implementation, but not through the MoFED or BoFED, and are often entirely 'off-budget' as far as MoFED and BoFED are concerned.

Figure 2.2: Schematic of funding channels to WASH projects



In past years in Ethiopia, aid flows to the WASH sector have largely taken Channel 3 (off-budget support) and Channel 2, as reported in the joint sector review (MoWR et al., 2006b). This approach is currently changing. A set of recommendations has been put forward for the development of a sustainable financing stream for the WASH sector in Ethiopia, which seek to meet the needs of the sector. These recommendations simultaneously attempt to match the ability of the sector to spend the resources effectively with the European Union Water Initiative (EUWI, 2006), facilitating the development of a financing strategy for the water and sanitation sector through an iterative and consultative process. The key recommendations made in this strategy were endorsed at the Multi-stakeholder Forum held in Addis Ababa in October 2006.

The practical steps to take towards sustainable financing of the sector in Ethiopia were elaborated using the undertakings of the Multi-stakeholder Forum as a starting point. The forum's Aide Memoire notes that 'developing a programmatic approach and strengthening monitoring and evaluation systems should be a priority focus for the year ahead' (FDRE, 2007a). This commitment is in line with the Paris Declaration, which states that 'Donors should commit to link funding to a single framework of conditions and/or a manageable set of indicators derived from the national development strategy' (OECD/DAC, 2005).

The financing strategy comprises three key elements:

1. Specific steps over the last 12-month period to strengthen the programmatic approach. Two key milestones for the strengthening of the programmatic approach were: to agree to a Sector Framework Agreement at a Financing Roundtable held in January 2007; and the second Multi-stakeholder Forum held in October 2007.
2. Development and alignment of financing mechanisms. A key milestone was the agreement to a Joint Financing Agreement at the Financing Roundtable in January 2007. The purpose is to improve the effectiveness of financing and to increase the resources available in the sector. The medium-term vision is to create a basket of pooled funds, with each pool designed to maximise financial flows and effectiveness in an appropriate niche area (capacity building, hygiene promotion, grant financing, loan financing, etc.) This is an evolutionary approach, and certain pooled funds (for example, a pooled capacity building fund) will be prioritised over others.
3. Other initiatives that will enhance sector financing over the medium term, but that should commence now. For example, strengthening M&E; improving the performance of WSS service providers; and undertaking reforms to make it easier for small-scale private sector operators and service providers to contribute to the sector.

2.3 How much progress been made?

The current debate on aid has created increased awareness of the effects of donor behaviour at national and international level. As a result, there have been significant changes in attitude. Donors are much more aware of the transaction costs they generate and governments are more willing to assert their own priorities and administrative requirements. In most developing countries, this has led to concrete improvements: joint working by donors is now common practice and the number of independent missions and review processes has certainly declined. Co-financing of projects (by two or three separate donors) or common basket funding to single projects or programmes by several donors is increasing, and more efforts are being made to achieve better division of labour between donors in country. However, a number of challenges remain:

- There are still too many separate missions and review processes. The acceptance of harmonised arrangements requires an acceptance of a diminished individual 'voice' for each donor agency. Many find this hard to accept and continue to demand individual audiences with senior government staff and the right to independent verification of the conclusions of joint reviews, at the same time as emphasising the continuing need for separate procedures.
- The number of off-budget projects continues to be very high. Even though donors are making it clear in policy pronouncements that they intend to scale up programme aid, at present budget support remains at 4-6% of total aid to low-income countries (CRS online, cited in World Bank, 2007). The biggest increase has come in sector programme aid; this encompasses 'non-traditional' project aid as well as sector budget support, and it is likely that a large share of the increase aid has come through increases in common funds. A large amount of aid is still delivered off-budget. Nevertheless, different sets of evidence suggest that the share of programme aid is rising. A survey of general budget support conducted annually since 2004 has found a consistent rise in the percentage of general budget support (SPA, 2006).
- For bilateral agencies like the UK Department for International Development (DFID) and some aid-dependent countries like Uganda and Tanzania, general budget support already accounts for between 20% and 40 % of total aid flows (de Renzio, 2006; IDD and Associates, 2006). An evaluation of Dutch bilateral aid found that the percentage of general budget support provided rose from 3% in 2000 to 18% in 2004 (MFA The Netherlands, 2006). There is some evidence that, not only is additional aid being provided through programme modalities, but also some aid is changing over from projects to programmes. Mavrotas (2003) for Uganda (1980-1999) and Mavrotas and Ouattara (2006) for Côte d'Ivoire (1975-1999) find evidence of this substitution. In Uganda, project aid is decreased for every increase in programme aid, with similar effects found in Côte d'Ivoire.
- While project interventions are clearly appropriate in certain circumstances, too many projects generate high transaction costs. At present, the use of off-budget aid modalities continues consistently to undermine the intended benefits of programme aid. Various analyses of sector performance find damaging effects of aid disbursed through a number of uncoordinated channels (EUWI, 2006; Government of Rwanda, 2006; Steffensen, 2006). In a synthesis of analyses of three sectors in Uganda, Tanzania and Mozambique, it was found that all three countries have experienced a more significant shift towards programme aid than other developing countries. However, despite this, the reality suggests that, even with a change to the mix of aid modalities at the sector level, this shift is not as clearcut as the new aid paradigm may suggest (Williamson and Agha, 2007).
- Even where financing is provided through the budget, conditions and reporting procedures tend to be excessively onerous. Direct budget support is potentially the most 'aligned' aid modality available to donors. Yet, the natural desire to limit fiduciary risks and promote faster policy and institutional development within recipient countries seems inevitably to bring about complex disbursement conditions and monitoring arrangements. Most performance assessment frameworks for general budget support incorporate matrices with an excess of 50 policy actions or performance indicators. Not all can be properly monitored, but the attempt to do so creates an administrative burden and inevitably diverts attention away from the most important issues.

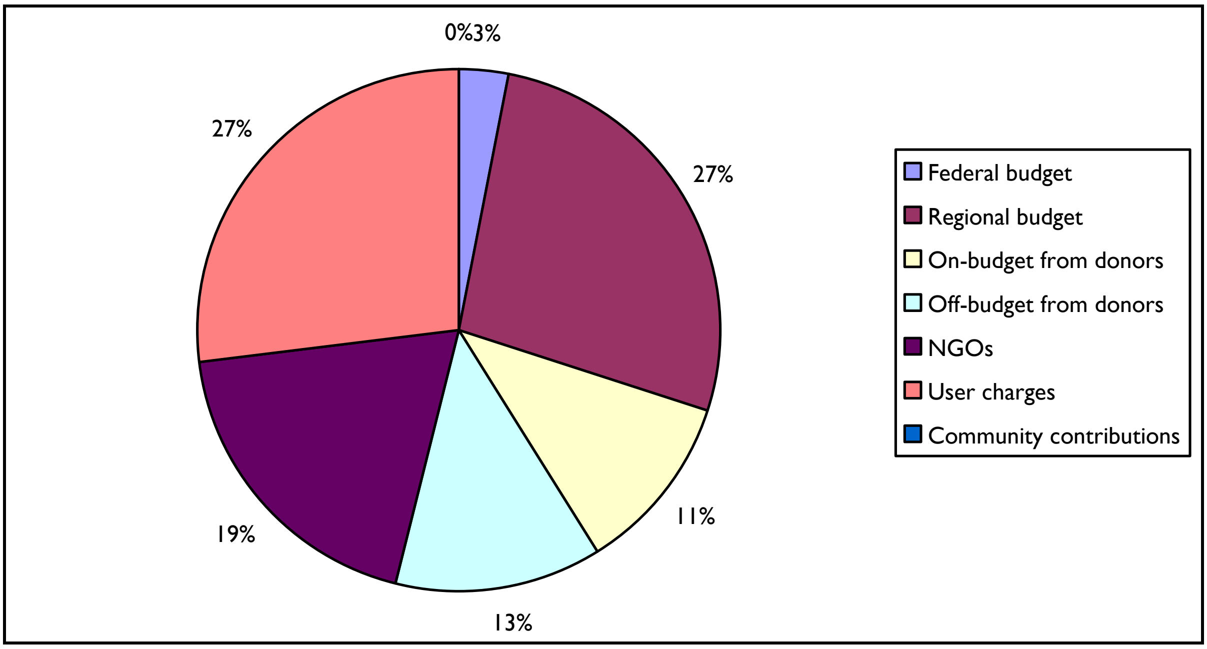
2.4 Financing sources: Current situation

Ethiopia follows a federal system, and decentralisation has resulted in the transfer of block grants from the federal government to regions and from regions to local governments (woredas). The federal constitution mandates sub-national regional governments with responsibility for key areas of basic service delivery and also gives the regional parliaments and woreda councils autonomy to decide how resources (from the block grant and own revenue) should be allocated across the competing sectoral needs at sub-national level.

The PASDEP shows water and sanitation declining significantly as a share of total poor-focused expenditure, from Birr 2709m/US$m (7.4% of the total) in 2005/06 to Birr 1815m/US$202m (3.4% of the total) in 2009/10. However, it is extremely important to point out that actual expenditure levels may fall well short of these levels. In 2005/06, according to the Financing Strategy (EUWI, 2006), around Birr 712m (US$79m) of funds were actually spent under the PASDEP, representing only 26% of the budget noted above. However, the estimate made by Tayler and Winpenny (2006) for the same year was 61%. Tearfund (2005) estimates that, on average, between 1998 and 2002, 82% of overall sector on-budget funds, but only 33% of off-budget funds, were actually spent by woredas. More work is necessary to obtain more exact figures, but there appears to be very strong evidence that a very significant proportion of resources available to the sector are not utilised. The Financing Strategy adds that resource flows into the sector can be increased significantly by paying attention to project cycle lengths and addressing project bottlenecks – these are key subjects in this diagnostic report of financial mechanisms.

The Financing Strategy estimates that the actual WASH sector budget for 2005/06 of Birr 712m (US$79m) came from: 3% federal budget; 28% regional budget (most of which was passed on from the federal level); 11% 'on-budget' from donors; 13% 'off-budget' from donors; 19% non-governmental organisations (NGOs); 27% user charges; and 0.1% community contributions. This gives an estimate of the source of funds as being 42% 'on-budget' and 58% 'off-budget'.

Figure 2.3: Estimates of actual WASH spending in Ethiopia



Source: Based on figures from EUWI 2006

Tearfund (2005) estimates that US$65m (Birr 585m) per year goes into the WASH sector, which is relatively close to the US$79m (Birr 712m) noted in the Financing Strategy.

2.5 Budget process principles: Transparency

As defined by Alemu et al. (2008), 'transparency involves the provision of user-friendly comprehensive, accurate, timely and frequent information on a country's budget process. Budget decisions are made on the basis of clearly spelt out rules, procedures, and forums. Such information should be made available and accessible to the general public, open to public scrutiny, and clearly written and readily understandable by the public.' In this regard, the experience of budget transparency in Ethiopia is limited. Alemu et al. find that 'though federal and regional budget laws and allocations appear in the Federal and Regional Negarit Gazetta, the official law gazette of the Government, neither of the gazettes is accessible to all citizens'.

In addition, citizens and civil society are not informed of how much is allocated to each sector/programme at all levels of government. There is also a lack of recognition by the government, particularly at lower tiers, that citizens and civil society have a right to know how much is allocated and how it is spent. However, since 2006, efforts are being made to institute an open budget system at all levels of government.

2.6 Budget process principles: Accountability

Accountability refers to a situation whereby decision makers and implementers can be held accountable for the way the budget is formulated, approved and implemented, and its performance can be reviewed by those whose interests are affected by their actions or inactions (see Alemu et al., 2008). Accountability involves all four budget cycle phases. In terms of budget preparation, this involves ensuring that the government keeps its commitment to stated policy priorities in allocations and that the executive body presents the agreed-on budget to the legislative. Accountability in budget approval means the budget must conform to laws and the Constitution. This includes quality budget documents; a clear criteria/process for allocating resources among regions; and certainty that public input into budget preparation is respected. Accountability in budget execution means checking that disbursement is in line with what is approved and that the budget is released without delay. Accountability in budget control refers to the absorption of the budget and efficient and effective utilisation of public money.

Accountability also covers objects of expenditure (what the state spends the money on); state performance and results (achieving results or meeting objectives in public spending); appropriate and timeliness of audit reports; and transparent procurement (see Shapiro 2001). Institutional arrangements are important for an effective accountable budget system. Accountability requires robust financial management systems and legislation, an independent auditor general, a strong parliament, active civil society, independent media and a vigilant electorate.

Ethiopian experience on accountability is modest. As pointed out by Alemu et al. (2008), 'although there are public hearings at the House of Peoples Representative at all tiers of government on budget performance, the participation of citizens and civil society is limited. In addition, budget reports usually focus on budget inputs and outputs with very little on budget outcomes.'

The Economist Democracy Index (The Economist, 2007) scores countries on five categories: electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture. Scores for each category ranges from 10 (best grade) to 1 (worst grade). Ethiopia comes out 106th out of 167 countries. Table 3.1 summarises the scores for Ethiopia along with some other countries for comparison purposes.

Table 2.1: The Economist Democracy Index: Ethiopia, South Africa and Burkina Faso

Country	Rank	Overall score	Electoral process and pluralism	Functioning of government	Political participation	Political culture	Civil liberties
South Africa	29	7.91	8.75	7.86	7.22	6.88	8.82
Ethiopia	106	4.72	4.00	3.93	5.00	6.25	4.41
Burkina Faso	119	3.72	4.00	1.79	2.78	5.63	4.41

Source: The Economist, 2007

2.7 Budgeting process for the water sector

Delivery of WASH services in Ethiopia is financed in a highly complex and fragmented way. The level of public resources available for the WASH sector is set nationally within a medium-term expenditure framework linked to the second-generation national development strategy (PASDEP). The dominant national policy focused on the WASH sector is the UAP, which was approved in November 2006 and aims to achieve full service coverage by 2012.

In practice, Ethiopia's federal system, which gives regional states a high degree of autonomy over their public finances, makes it impossible to predetermine with any precision the levels of funding to services delivered by regional and local government.[2] Ethiopia operates a financial system with large intergovernmental transfers of public revenue flowing from federal to regional levels of government and in most regions on to woreda level. How the block grant pool is divided among regions and woredas is the subject of intense year-on-year negotiation at federal and regional level, respectively.

The proportion of these funds allocated to different sectors, including WASH, depends on regional governments' and woredas' own priorities. In practice, regional governments submit financial reports to the federal government. The discretion over the allocation of these block grants to sectors is limited by existing commitments, capacity and staffing levels. Initial scoping studies have found that, at decentralised level, salaries, set at federal level, absorb a large proportion of block grants. This was most acute at the woreda level, where block grants only just covered salaries, with some woredas having to borrow from next year's block grant to cover salaries.

This top-down transfer of resources is supplemented at the local level by tariff revenue generated through user fees and community contributions to capital investments in the form of in-kind and cash contributions. At village level, this is through community-managed schemes; in towns, it is carried out by semi-autonomous utilities.

[2] The federal government can and does earmark portions of the block grant for federal programmes.

2.8 Cost recovery mechanisms

In rural water supply, the Water Resources Management Policy states that communities will contribute to the capital cost of the construction of small-scale schemes and cover the full costs of operation and maintenance (MoWR, 1999). In urban areas, the UAP states that schemes for 5000 people or fewer will be fully funded by the government, that schemes for more than 10,000 people will be covered by loans from the Water Resources Development Fund (WRDF) and that schemes for between 5000 and 10,000 people will be covered by a combination of government subsidies and WRDF loans.

In terms of sanitation, Thomson (2007), citing the Needs Assessment to Achieve Universal Access to Improved Hygiene and Sanitation by 2012 (MoWR, et al., 2006a), notes that rural households are expected to build their own latrines, with some support to the very vulnerable. Communities will be expected to contribute between 5% and 10% to the cost of institutional latrine construction. In urban areas, the needs assessment states that households will also have the prime responsibility for latrine construction, except in 'congested poor areas'. Community latrines in urban areas will be funded from a combination of user contributions, private investment, soft loans and public finance. Rural hygiene and sanitation software costs will be met out of woreda public finances plus donor grants, which may include a performance-related element. Urban software costs will be covered by a combination of local funds, user contributions, private finance and 'challenge funds'.

For effective financing of a sector, the unit costs and quantities involved must be known, along with the requirements of the sector in the future and how unit costs may change.

2.9 Unit costs: An overview from Ethiopia

In Ethiopia, the EUWI has been instrumental in producing the Financing Strategy for the Water Supply and Sanitation Sector, which includes unit costs for water supply, sanitation and hygiene in rural and urban areas.

Ethiopia's federal system, which gives regional states a high degree of autonomy over their public finances, makes it difficult to predetermine with any precision levels of funding to services delivered by regional and local government. There is a top-down formula allocation, which is based on national-level unit costs for WASH and does not take into account regional differences. At the same time, there is an intense discussion on priorities at regional level and budget allocations for WASH, which are not very transparent and end up covering only recurrent costs (i.e. salaries).

2.9.1 Capital investments

The rural UAP provides the cost per capita for different types of schemes, which vary according to regional differences (number of people per scheme, for instance). Table 2.2 shows the average costs per scheme, and average number of people per scheme for the country as a whole (EUWI, 2006).

There is a need for costs from a service perspective for the whole of the population (un-serviced and maintenance of already serviced), not only from a system perspective, which considers only the un-serviced. A system perspective will also not look into capital maintenance costs or direct support costs, which are essential to guarantee sustainability in rural water services. There is often a trade-off between capital investments and operation and maintenance costs. The choice of delivery mode is biased against the capital-intensive solution if data on maintenance are not available, or unreliable, because it will look 'cheaper'. Likewise, choices tend to be biased when they are made on the assumption that required maintenance is actually carried out when in reality it often is not.

Interestingly, Carter et al. (2006) added failure (very common in Ethiopia) to the unit costs of a post-construction. For example, the costs of drilling a dry borehole are around 60% of a successful drilling.

Table 2.2: Rural water UAP costs

	Avg. people per scheme	Total no. of new schemes	Avg. cost per capita (Birr)	Total cost (Birr m.)	Total pop. by scheme type (000s)	Expected prevalence (%)
Unlined hand dug well	75	69,745	40	209	5231	10.9
Lined standard well	270	38,568	97	1014	10,413	21.7
On spot sprint development	338	14,426	99	481	4876	10.2
Small spring – motor & gravity	900	210	94	18	189	0.4
Small spring – motor	2500	90	144	32	225	0.5
Small spring – gravity	5000	325	110	179	1625	3.4
Medium spring	5000	438	191	419	2190	4.6
Shallow borehole	457	9737	370	1648	4450	9.3
Shallow borehole w. hand pump	425	9510	188	761	4042	8.4
Motorised shallow borehole	2400	1570	101	381	3768	7.9
Motorised deep borehole	3313	2986	223	2206	9893	20.6
Others (surface, large scheme)	28,756	22	1017	643	633	1.3
Solar pump borehole	1750	36	391	25	63	0.1
Windmill borehole	1750	18	334	11	32	0.1
Masonry cisterns	50	57	6000	17	3	0.0
Hand pump fitted ponds	350	565	243	48	198	0.4
Plastic lined cisterns	117	721	185	16	84	0.2
Total costs		**148,402**	**160.5**	**7690**	**47,913**	
Avg. cost per capita US$			**18.4**			

Source: MoWR (2006).

2.9.2 *Operating and minor expenditures*

There are no details on operating and maintenance costs in the UAP. The UAP assumes that basic operation and minor expenditures will be met through user fees.

Table 2.3: Social sector spending to achieve MDGs as a % of gross domestic product (GDP)

	2003/04	**2005/06**	**2010/11**
Recurrent spending			
Education	3.6	4.4	5.3
Health	1.9	2.7	3.1
Water supply	0	0	0
Safety net	4	3.7	3
Sub-total	**9.5**	**10.8**	**11.4**
Capital spending			
Education	2.5	2.6	3.3
Health	0.5	0.7	0.7
Water supply	1	1.4	1.7
Safety net	0	0	0
Sub-total	**4**	**4.7**	**5.7**
Total	***13.6***	***15.5***	***17.1***

Source: Mattina (2006).

2.9.3 Capital maintenance expenditure

No allocations are made for depreciation, rehabilitation, etc., which effectively means that sustainability of existing systems is very limited. For instance, a high proportion of rural water facilities will turn out to be non-functioning at any time. More attention should be focused on how capital maintenance can be recovered when discussing service levels and technology options. It cannot be expected that communities will be saving for capital maintenance over periods of 10 to 20 years. The result is the all-too-common lack of capital maintenance, such that systems fall into disrepair and users cannot access the desired benefits until the cycle begins again with the provision of a new or rehabilitated facility.

2.9.4 Direct support costs

Within the UAP, capacity issues have been identified and costed, including manpower requirements, training costs, equipment for artisans and area mechanics. However, some of the UAP premises, such as multi-village gravity schemes, require a higher level of skills. These capacities have not been taken into account, neither have the capacities required at management and oversight level.

2.9.5 Indirect support costs

The UAP states that the MoWR, WRDF, BoWRs and town water boards will be involved in M&E activities, but there is no costing for these. In rural areas, there are four levels of monitoring: community/kebele, district/woreda, regional and national. The funds required for monitoring is available at all these levels, and data will be collected at ground level and ultimately fed up to the national level.

Interestingly, for sanitation, the UAP provides costing of some direct and indirect support expenditures. Table 2.4 provides a summary of the rural and urban sanitation investment needs assessment.

Table 2.4: Rural and urban sanitation investment needs assessment (2007-2012) (US$m)

	Software	**Hardware***	**Water quality**	**Capacity building**	**M&E**	**Total**
Rural	29.7	346.6	2.1	29.7	0.9	408.9
Urban (excl Addis)	10.7	151.4	8.9	32.9	0.5	204.3
Total	40.4	498	11	62.6	1.4	613.2

Note: * Figures subject to confirmation. Source: MoWR et al. (2006a).

2.9.6 Unit costs: Conclusions

There cannot be proper planning and budgeting by local governments, donors and other stakeholders without quantitative data to support – and even drive – these processes. In the context of decentralisation, local governments, utilities, NGOs and other service providers need strategies for improved cost recovery and increased service coverage, particularly for the poorest. These strategies must be informed by a rigorous analysis of quantitative data related to the magnitude and adequacy of finances available to meet capital and recurrent costs.

Community management systems are not sustainable because they fail to involve local government.

The community management service delivery approach has been seen as the solution to WASH problems in rural areas. However, this approach has bypassed local government authorities and reduced their ownership of projects. In the past couple of years, it has been found that, if rural services are to be sustainable and scalable, they need facilitation from existing authorities. In rural water supply, utilising community management needs to be handled like utilities, if it is to be scaled up. Access to accurate disaggregated costs relating to sustainable delivery of safe water, sanitation and hygiene services is fundamental to improving the design, implementation, operation and maintenance of WASH services delivery. Access to this information is also fundamental to improving cost efficiency, transparency and accountability of WASH services delivery.

3 Channel 1 Financing

3.1 Literature


Washing gold: Gold is an important traditional economic base in Benishangul-Gumuz.

Ethiopia has the lowest water supply coverage in sub-Saharan Africa (World Bank, 2004a). Only 43% of the population had access to safe water in 2006/07. In the Benishangul-Gumuz region, these problems are even more apparent. In Ethiopia's poverty reduction strategy (PASDEP), the main objective for the water and sanitation sub-sector is that, by 2010, the percentage of the rural population with access to potable water will be 80.5%.

Unfortunately, in Ethiopia, efforts to provide and sustain water and sanitation facilities have not achieved their intended objectives. Besides a need to increase investment in the sector, there is evidence of an inability to utilise Channel 1 funding efficiently and effectively (government budget and donor money in the form of loan and grants coming through the Federal Treasury rather than sectoral ministries). This raises questions as to the wisdom of allocating additional resources rapidly using these funding channels.

This brief highlights some of the major findings and policy recommendations from a study carried out by RiPPLE on Channel 1 funding, its allocation and utilisation. The study was conducted in Benishangul-Gumuz, one of the regional states of Ethiopia. This region was highly marginalised by previous regimes and is known for its deep-rooted poverty, arising not only because of economic resource limitations but also because of many other interrelated factors, which would merit further independent investigation. The PASDEP states that 'over 70% of the households in Amhara and Benishangul-Gumuz use unsafe water from rivers, lakes and unprotected wells or springs'. It is believed that the lessons and recommendations drawn from this study will be applicable and of benefit to the water sector on a national level.

3.2 Study findings: Budget allocation data

3.2.1 National

The budget shares allocated for the water sector in EFY 1994 (2001/02) and EFY 1995 (2002/03) were 1.3% and 1.9% of the total budget, respectively, and were close to zero in EFY 1999 (2006/07) (EEA/EEPRI, 2007). As noted above, water and sanitation is one of the pro-poor sectors in the PASDEP, with 6.5% of the indicative spending share. This suggests that, in the annual budget, the share of this sector was insignificant, and reveals a discrepancy between the PASDEP and annual budget sectoral priorities.

As in other sectors there are data problems, but it appears that total spending – both urban and rural, on investment and operations – is about US$53m per annum, including bilateral and multilateral donor financing, but excluding much of the NGO financing, which, owing to the large number of actors, is difficult to calculate. Reports indicate that the investment requirement for rural water supply spending amounts to about Birr 12.6 billion (US$1.5 billion) between now and 2015. This would result in coverage of about 64% of the population by 2015, consistent with the MDG for water supply. This would require an annual level of spending of about US$115m per year on average, about five times the estimated current spending on rural water. This is unlikely to be affordable.

3.2.2 Regional: Benishangul-Gumuz

According to data obtained from BoFED, the total amount of Channel 1 funding allocated by the Benishangul-Gumuz regional government for the past five years to the water sector for capital expenditure is over Birr 31m. The amount of budget allocated to the sector in the region and the proportion of the total budget for the past five years is illustrated below.

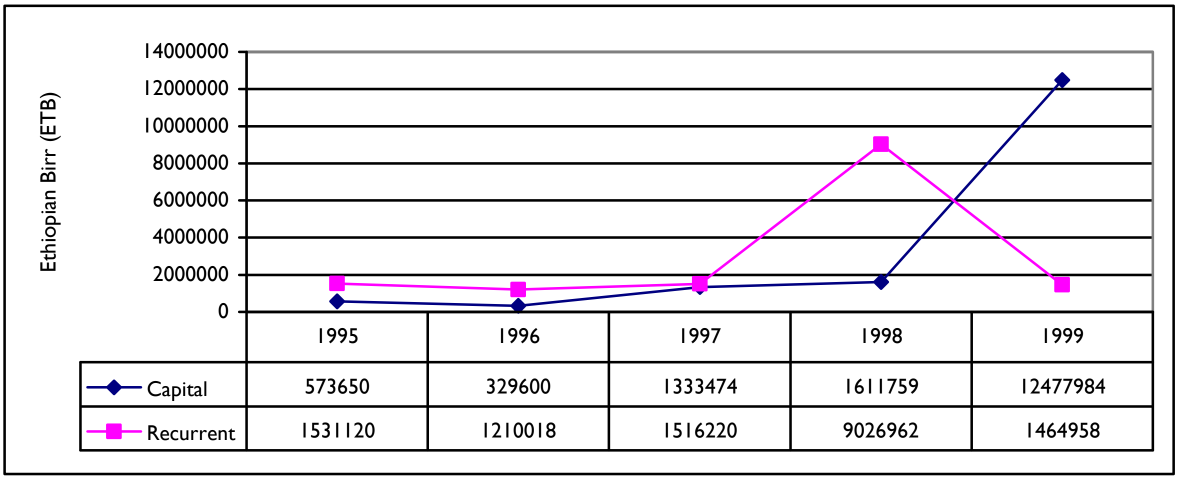
Table 3.1: Share of water sector budget from total regional budget

EFY	Federal government block grant to region (Birr)	BoWR budget (Birr)	Share of BoWR from grant (%)
1995	241,100,000	2,104,770	0.87
1996	177,510,000	1,539,618	0.87
1997	185,240,000	2,849,694	1.54
1998	221,910,000	10,638,721	4.79
1999	254,340,000	13,942,942	5.48
Total	**1,080,100,000**	**31,075,745**	

Source: BoFED, various budget documents.

For the purpose of this chapter, allocations and expenditure have been separated into two broad categories: capital (capital items or fixed assets such as land, buildings, roads, equipment) and recurrent (day-to-day operating expenses such as wages and salaries, administration, purchase of goods and services for current consumption, acquisition of furniture and equipment, inputs used in service delivery, etc.). It is difficult to carry out large capital projects with low recurrent costs, and high recurrent costs with no capital expenditures could illustrate ineffective use of time.

Figure 3.1: Trends in capital and recurrent budget allocation in Benishangul-Gumuz (Birr)



Source: BoFED, various budget documents.

Benishangul-Gumuz has 22 woredas. The recurrent spending allocation for EFY 1999 of Birr 1,464,958 represents only Birr 66,000 per woreda (approximately US$7000) for all operations, salaries and inputs for service delivery.

3.2.3 Budget allocation: Findings

Despite strong commitment by the government in its policy documents, the budget allocated to water has been very low compared with other basic service sectors, at both federal and regional levels, including in Benishangul-Gumuz.

Channel 1 budget allocation to the water sector, at regional and woreda levels, has been much lower than is required for improving access to safe water. The growth trend in the study areas has been inconsistent, as has the allocation of the water budget into capital and recurrent budgets.

There is a discrepancy between the poverty reduction policy priorities and annual budget sectoral priorities. Allocations for capital and recurrent costs are inconsistent from year to year.

3.2.4 Budget utilisation: Data

Table 3.2 below illustrates how variable the utilisation of budgets is in different woredas. The utilisation rate ranges from 0% (which occurred four times over the study period in different woredas) to 100% in Menge woreda in 1995 (EFY). The data also illustrate how peculiar the operations of different woredas are, with numerous examples of capital expenditure being spent in woredas utilising 0% of their recurrent budgets, suggesting that projects are being carried out without any day-to-day expenses such as salaries.

Table 3.2: Budget utilisation rate trends in water sector: Variance rate of study woredas (%)

EFY	**Pawe woreda**			**Sirba Abay woreda**		
	Capital	*Recurrent*	*Total*	*Capital*	*Recurrent*	*Total*
1995	2.9	-	2.9	97.4	-	97.4
1996	100.0	9.8	44.5	0.0	-	0.0
1997	12.7	0.2	3.6	13.9	73.1	14.8
1998	-	0.0	0.0	-	0.0	0.0
1999	4.5	3.7	4.1	10.3	-50.0	4.7
EFY	**Kurmuk woreda**			**Menge woreda**		
	Capital	*Recurrent*	*Total*	*Capital*	*Recurrent*	*Total*
1995	1.7	-	1.7	100	-	100
1996	82.0	1.0	69.5	100	20.9	80.2
1997	0.0	18.6	0.6	0.0	1.7	0.4
1998	-	0.0	0.0	2.5	0.0	1.4
1999	-	58.4	58.4	-	2.9	2.9

Source: BoFED, various budget documents. Cells with no percentage given were not allocated any budget for the sector in the given year.

The participants of field group discussions, carried out as part of the study, reasoned that budget underutilisation arose as a result of a lack of capacity; delays in budget allocation and disbursement; a lack of an efficient and effective M&E system; inadequate coordination; unavailability of competent and efficient contractors; managerial and leadership problems; and a lack of community and expert participation in budget formulation, allocation and utilisation.

3.2.5 Budget utilisation: Findings

- There has been under-spending of the Channel 1 water budget in the study woredas.
- The growth trend of the Channel 1 water budget in individual districts can be inconsistent, with erratic ups and downs that do not reflect the steady increase of the overall government budget at federal, regional and woreda levels.
- There are problems with: lack of coordination and structural clarity in the water sector; lack of consistent and well-organised data; delays in financial disbursements; lack of effective and systematic M&E; and prevalence of centralised budget allocation at woreda level.

3.3 Recommendations

3.3.1 Suggestions for improved allocation of the Channel 1 water budget

- Budget decision makers, i.e. Cabinet and Council members at regional and woreda levels, should be given capacity building support (e.g. creating awareness of relevant government policies, such as the PASDEP, MoFED budget guidelines, etc.)
- The level of oversight of budget allocations should be enhanced, particularly by the Budget and Finance Standing Committees of Councils at all levels.
- Appropriate mechanisms should be designed and put in place to ensure public budget allocations at woreda level are based on local community needs and priorities.

3.3.2 Suggestions for efficient utilisation of the Channel 1 water budget

- Improvements are needed in the way that budget information is accounted, audited, monitored and evaluated and presented, in order that meaningful analysis can be carried out. At a minimum, the budget system should provide a classification of government expenditures by functional category as well as by administrative unit.
- Greater autonomy over allocated resources should be complemented by arrangements such as sound rules, regulations and working procedures, to enhance accountability – ones that not only improve honesty and stewardship in the use of budget resources but also enhance the quality of associated outputs and outcomes.
- The field group discussions found that resources tend to get delayed at the regional level of the administrative hierarchy, preventing operational departments from accessing the resources on time and spending the budget effectively and efficiently. This requires that sectors and line agencies develop strategic plans as inputs to the overall water sector strategy. Four further recommendations are suggested to deal with these delays:
    a. Giving line offices, operational departments and associated service delivery units greater autonomy and flexibility in using resources to meet water sector objectives (within the operating budget constraint);

   b. Holding desk/bureau heads accountable for adherence to spending limits;
   c. Linking budgets to performance targets, focusing attention on the services provided rather than on the institution's needs;
   d. Monitoring performance and rewarding personnel based on results that can be linked to poverty reduction and efficiency goals.

- A main obstacle to using a budget effectively regards poor government finance management systems for the development and implementation of plans. Seven ways in which scarce public resources can be managed more effectively to fulfil the objectives of the sector are listed below:
   a. Clarify the assignment of roles and responsibilities in the water sector. This should be the first step, because it will also help clarify the funding of activities to raise coverage and improve service delivery in the water sector. In particular, there is a need for clarity on the roles of Water Desks in the Agriculture and Rural Development Offices;
   b. Ensure better resource planning. To encourage the translation of long-term strategies into programmes, improve the correlation between resource availability and spending and increase the effectiveness and efficiency of spending by requiring line officers to better define their goal and activities and link spending to these;
   c. Improve transparency and strengthen accounting and auditing as well as procurement practices at woreda level;
   d. Focus on performance. Woreda budget planning and allocation systems have traditionally not emphasised control of resources over achievement of outcome-oriented objectives. Instead, budgets have often been allocated to line offices on a historical basis and without consideration of goals or performance;
   e. Encourage participation in the budget process. Transparency and accountability are also important components of public expenditure management, which aims to improve the effectiveness of government spending. Involving those who are supposed to benefit from government services in budget preparation and monitoring will improve public spending;
   f. Strengthen the structure of woreda-level institutions. As they are closer to service users, woreda Water Desks are more likely to reflect the needs of the community in their development priorities.
- Improve information and M&E systems (especially with regard to budgets). These are necessary if the sector is to assess continually not only the adequacy of budgets but also the efficiency and effectiveness with which expenditures are being made.

4 Matching Funds/Channel 2 Financing

4.1 Literature

4.1.1 Introduction to fund allocation and matching funds

In past years in Ethiopia, despite great attention to WASH, there have been numerous problems related to the implementation of projects. These problems have included issues of sustainability, budget utilisation, timely implementation and spare parts supply, among others.

A RiPPLE study to investigate some of the issues relating to the implementation of large programmes in this sector placed particular focus on the World Bank's Ethiopian Water Supply and Sanitation Project (EWSSP) and its requirements for matching funds. Specific objectives were as follows:

- To identify factors influencing the allocation and utilisation of matching funds to the EWSSP in Benishangul-Gumuz regional state.
- To identify recourse measures to solve the problem of matching funds for the EWSSP in Benishangul-Gumuz regional state.

As we have seen, Ethiopia has two main channels for budgeting and transferring financial resources to regions, Channel 1 and Channel 2. Channel 1 refers to direct budgeting and transfer from MoFED to regional BoFEDs and from there to woreda level. This funding channel is considered 'on-budget', as resources are part of the planning and budgeting process of public resources and are accounted for in the relevant budgets. The Channel 1 system has advantages – it enables proper knowledge of and control over resources – and disadvantages – it can entail long bureaucratic procedures.

Channel 2 involves budgeting and transfer through sector ministries, e.g. MoWR, and transfer through respective budget implementation units at regional and woreda level. The EWSSP follows this system. Channel 2 allocations target beneficiaries more exactly, but this may be donor targeting rather than nationally aligned; in addition, such support may risk leading to the establishment of a parallel system, given that it may not be captured within national systems (Bladon, 2007).

A third way of channelling funds, otherwise known as Channel 3, involves transferring financial resources from the donor or NGO either directly to the regional sector bureau or through a project implementation unit. MoFED considers Channels 2 and 3 'off-budget', as donor and NGO support remains outside the planning and budgeting process of public resources. This has distorted overall public expenditure planning and implementation. 'Off-budget' arrangements for WSS have been the subject of some discourse between BoWRs and BoFEDs.

According to the agreement between MoFED and the Bank, allocation and utilisation of matching funds are conditions for accessing donor funding. The Bank covers 85% of the statement of expenditure provided to it, except in the category of trainings and capacity building, where it covers 100% of the cost. The region is supposed to cover the rest, in the form of matching funds. Benishangul-Gumuz has been unable to properly hold and utilise the 15% matching funds for which it is responsible. Such difficulties can directly and/or indirectly impact utilisation of the donor's funds.

The objective of this case study was to resolve the problem of matching funds sourcing for the World Bank EWSSP and similar projects of other donors in the long run.

4.2 Study findings

4.2.1 Understanding

Different donors have different requirements in sharing costs for programme implementation. The UN Children's Fund (UNICEF) and many international NGOs demand in-kind contributions such as labour and local materials; all UN organs and most NGOs demand value-added tax (VAT)-free services and duty-free privileges; and the International Development Association (IDA) demands cash contributions. This lack of synergy from the international community on the method of matching fund provision creates confusion and extra costs for the Ethiopian government. Furthermore, differing proportions are applied. The EWSSP requires 10% of matching funds from the government and 10% (5% cash and 5% in-kind contributions) from the user community (total of 15% cash). The 5% community cash contribution is to be used for the net water scheme costs only. These proportions are interpreted in different ways in different districts; for example, in Amhara, rural communities contribute 3% in cash and 7% in kind. Towns contribute 5% in cash. This shows that there is no clear-cut implementation guideline across the different regions.

The study showed that there is a shared understanding about the reason for the provision of matching funds and responsibility among the different players in the community, government and donors. However, respondents' understanding of the IDA conditions for matching funds as well as guidelines for administering matching funds was not so clear. In addition, allocation and utilisation of matching funds differ from region to region.

4.2.2 Allocation

There is a problem of matching funds allocation and expenditure in the EWSSP in general; matching funds are not generated or passed on by BoFED, because of poor communication and bureaucratic confusions between Channel 1 financing (matching funds and regional block grants) and Channel 2 financing (EWSSP funds).

Many woredas have found it difficult to allocate matching funds because of low financial capacity (block grant and own revenue) and competing demands by all sectors. As a result, no evidence of actual transfer of money as matching funds has been observed in the study area. Woredas have the potential to allocate and use matching funds, but this is not being done. There is limited capacity to hold the budget, in both the woredas and the regions. Moreover, because of the limited financial capacity of communities, getting cash contributions has been challenging.

The amount of revenue collected at each level as matching funds is taken into consideration when allocating block grants to woredas. Actual collection by woredas is usually much lower than planned. This creates a problem in allocating a budget for matching funds. In addition, the less populated regions are exposed to greater budget deficits which, ultimately leads to additional problems in matching funds allocation.

Recent progress, which involves the setting up of WASH implementation structures and guidelines and the harmonising of financing channels, will undoubtedly improve the performance of the water sector. However, it is necessary to have actual integration of sector bureaus in order to be able to propose alternative solutions for the problem of matching funds. In all regions, there was low integration and a communication barrier between sector bureaus and woredas. This leads to a lack of allocation of funds and finally to an under-spending and lack of use of donor funds.

According to the IDA Implementation Guideline and Procurement Plan (2005), matching funds are the costs shared by the government and the community as part of project costs. Regions cover the government contribution for activities to be carried out at regional level. Woredas provide counterpart funds for activities to be carried out at woreda level.

The World Bank EWSSP is a federally negotiated programme signed between the World Bank and MoWR through MoFED. Regions are not involved in the negotiations.

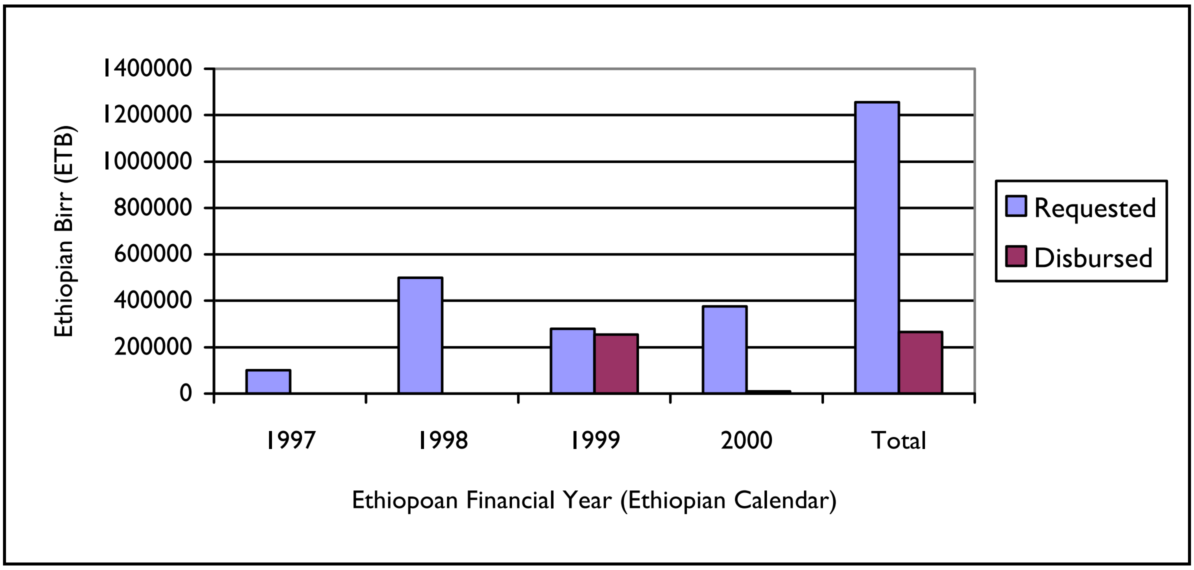
4.2.3 Issues arising in fund flows

The EWSSP is negotiated at federal level and donor funds flow directly from MoWR to BoWR through Channel 2. The Benishangul-Gumuz BoFED, the government organ responsible for allocating the matching funds (i.e. Channel 1 funds from the Treasury), is not officially aware of the programme. This makes it difficult to coordinate channels and maintain clarity in allocations. The study reconfirms that the coexistence of different mechanisms for funding to the water sector has been problematic. The flow of funds through Channel 2 means that BoFEDs do not have a comprehensive picture of the total amount of financial resources flowing to the sector.[3] This affects equitable distribution of resources among bureaus, woredas and communities and means a lack of ability to meet the matching fund requirement.

4.2.4 Fund flows

There has been a series of problems concerning disbursement of funds from BoFED to the project. These include requests for disbursements not being made on time and quantities requested not being disbursed. In percentage terms, actual allocation by BoFED is 2.66% for World Bank projects.

Figure 4.1: Discrepancies between requested and disbursed funds



During data collection, some respondents highlighted a communication barrier between BoFED and BoWR. One respondent said: 'since nobody has any experience, the challenges are not clear. But it

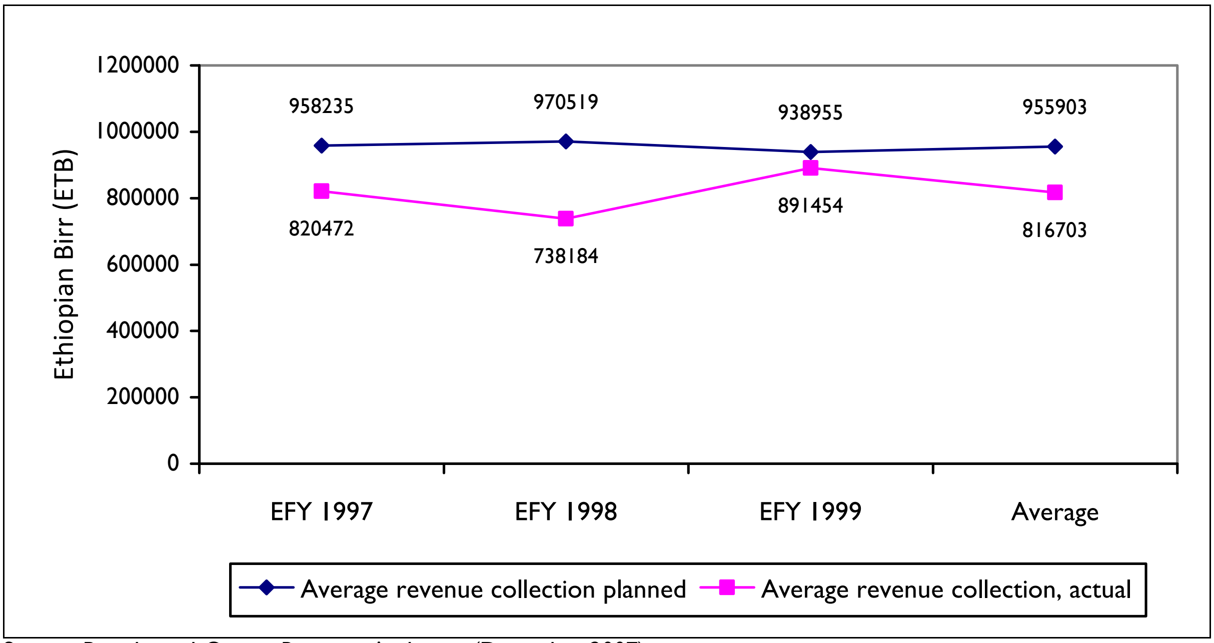
[3]According to an official in the World Bank, the Bank agreed with MoFED to release the project budget through Channel 1 starting in EFY 2000 (September 2007).

is clear that woredas find it difficult to allocate matching funds owing to delays in releases.' Other respondents mention weak capacity of zonal and woreda project offices.

4.2.5 Revenue collection

The capacity of the woreda to generate sufficient revenue is also weak because the tax base is narrow. For instance, the major sources of revenues are income tax (from a few government staff), business tax, agricultural land tax and rural land tax, all of which are insignificant. Generally, a lower amount of funds is collected by revenue authorities than planned. This underperformance has its own impact on the capacity of the woreda to allocate matching funds. Although woredas have signed the grant agreement to allocate matching funds, so far this has not been implemented.

Figure 4.2: Average regional revenue collection plan and implementation, EFY 1997-1999 (2004/05 to 2006/07)



Source: Benishangul-Gumuz Revenue Authority (December 2007).

4.2.6 Scarcity of budget and competing demands for resources in woredas

There is a belief that a scarcity of budget and competing demands for resources (by all sectors) led to non-allocation of matching funds. One respondent highlighted this in a focus group discussion by stating that: 'woredas are unable to hold the matching funds owing to budget deficits'.

4.2.7 Low financial capacity of communities

Communities have a low capacity to contribute 5% of the investment cost in cash. Even when communities are willing to contribute, the abandonment of drilled shallow wells that produce low yields have presented tremendous challenges for the community financing of schemes.

Regional governments or BoWRs have financed some activities on a reimbursable basis.

In spite of the challenges, communities have started contributing their share of the commitment and finances collected are deposited in banks. However, respondents in all the regions felt a 5% cash contribution was beyond the capacity of communities and suggested in-kind contributions instead.

4.2.8 'Hidden costs'

Hidden costs present a further challenge to the implementation of WASH programmes. These may not be taken into consideration in budget planning and when signing matching fund agreements with donors. Examples include: bank service charges; VAT; import tax for vehicles; equipment; salary expenses; depreciation on vehicles; and office utilities and running costs.

4.2.9 Fiscal calendar discrepancies

There are differences between fiscal calendars, which cause a mismatch between the two fiscal years and create problems in allocating budgets and M&E of performance/reports. The annual budget at all administrative levels is allocated in June and July. A request for allocation of matching funds in January, for instance, will cause a problem, as budget appropriation is completed by then. Another danger is that the woreda may be able to earmark a budget for matching funds, but delay in the signing of agreements or a time gap may lead to reallocation to other priority areas. Furthermore, different budget calendars mean different requirements and disbursement schedules; different reporting timeframes and auditing; and inefficient use of resources.

This is not a problem for the IDA-financed EWSSP, as the Bank uses the Ethiopian fiscal calendar as defined in the grant agreement. However, it is a problem for other donors, such as UNICEF.

4.3 Recommendations

The following recommendations for future actions have been identified:

- For communities, paying cash contributions should be optional, with the community having the option to pay in-kind, such as through labour, guard work, local material support or fencing. Overhead costs should be considered as matching funds on the part of the local government.
- To improve communication and integration, the memoranda of understanding (MoUs) between sector bureaus and woredas should be fully implemented. In addition, a tripartite agreement between BoFED, BoWR and the woreda Water Office should be established, to create a common understanding and to simplify implementation of activities. Sectors should hold strong periodical joint M&E missions.
- The government of Ethiopia (MoWR) should clearly inform MoFED, and MoFED should inform its regional bureaus, about any agreements made with donors.
- Regions should be given the opportunity to comment on the process of negotiation and its content. Regions have better know-how on the actual situation in the woredas and lower-level communities.
- Capacity to allocate matching funds is a problem in all regions. The economic level of the people and the government should be given due consideration.
- A mechanism should be put in place by the federal government to help less populated regions fill the gap arising from the budget deficit.

5 Implications for Policy and Planning in Ethiopia

- It is vital that donor and NGO support for any sector is coordinated and aims to increase the capacity and ability of the government to continue to implement programmes and projects. Without a coordinated effort in this regard, the integrity of the government can be compromised, and the potential for a long-term sustainable improvement in the WASH sector diminished.
- It is vital that all agencies and partners that require matching funds do so in a unified manner, with similar rules, ratios and delivery methods. The current situation of different procedures on different timetables coming from different funding sources adds large administrative costs to the process of supplying matching funds, diminishes the success of such processes and causes confusion throughout government departments.
- The poor utilisation of funds in the WASH sector and their erratic allocation is a vicious cycle that needs to be broken. Poor utilisation of funds already allocated is a cause for reductions and delays in future allocation, which in turn disrupts planning and leads to poor utilisation. Capacity and consistency is required in this area, with longer-term allocation commitments being introduced in collaboration with training in budgeting and spending.

The government has committed a great deal of effort and resources to the WASH sector, as is illustrated by its prominence in numerous poverty reduction papers and strategies. However, these verbal and written commitments need to be further supported with large contributions of government resources, which meet the proportions suggested in the PRS.

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RiPPLE is a DFID-funded Research Programme Consortium

RiPPLE Office
c/o WaterAid Ethiopia,
Kirkos Sub-city,
Kebele 04, House no 620,
Debrezeit Road,
PO Box 4812,
Addis Ababa, Ethiopia

t: +251 11 416 0075
f: +251 11 416 0081
e: info@rippleethiopia.org
w: www.rippleethiopia.org

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