

## MAINSTREAMING THE COMMUNITY DEVELOPMENT FUND FINANCING MECHANISM



**FINAL EVALUATION REPORT**  
**April 2010**

## ACKNOWLEDGEMENTS

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*Cover Photos: CDF financed water schemes in use across the Amhara Region (W. Davies)*

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## EXECUTIVE SUMMARY

### Part 1 – Evaluation of CDF

#### Introduction

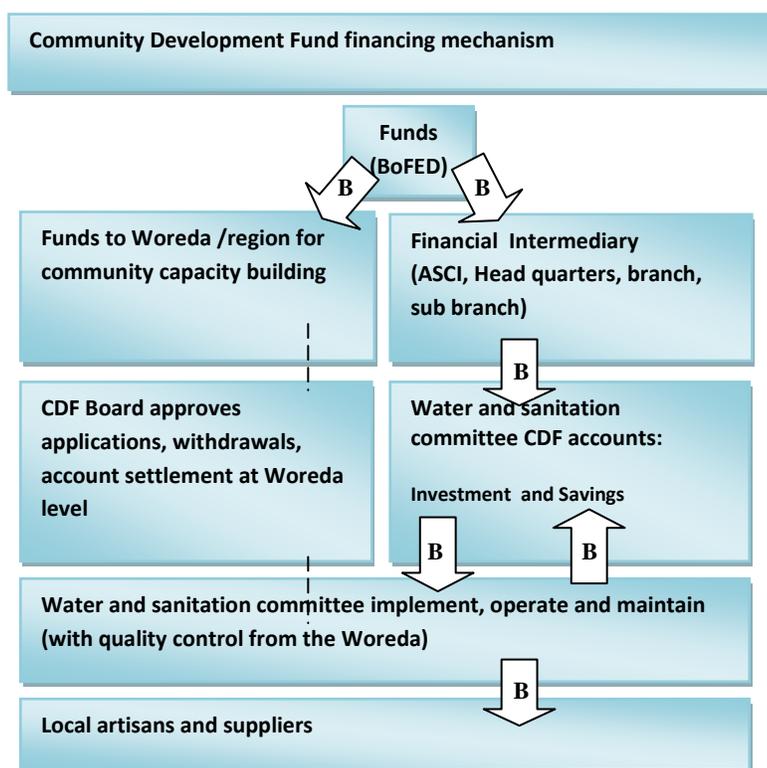
Rural water supply coverage in Ethiopia has risen substantially since the early 1990s. A significant increase in the scale of financial resources available to the sector, both from government and donor source, has supported this progress, particularly in the last 5 years. Over the years, many different delivery models have been used with varying success.

A prominent and successful financing mechanism in use is the Community Development Fund (CDF), developed under the Finnish-Ethiopian bilateral Rural Water Supply and Environmental Programme (RWSEP) in the Amhara region of Ethiopia. RWSEP has supported rural water supply since 1994 with financing via the Community Development Fund being introduced progressively between 2003 and 2006 during the third phase of RWSEP (Phase I, 1994-98; Phase II, 1998-2002; Phase III, 2003-06; Phase IV, 2007-11).

Since 2007, funds have been transferred via the Bureau of Finance and Economic Development (BoFED) at regional level. Since 2008 the program has expanded to also include the Benishangul-Gumuz region.

A unique and innovative feature of the Community Development Fund is that it transfers funds for physical construction directly to the communities via a micro

credit institution: the Amhara Credit and Savings Institution (ASCI), in the case of Amhara. The communities, through a water and sanitation committee (WATSANCOs), are responsible for the full development process, through planning, implementation (including procurement of most materials and labour) and maintenance. The communities contribute 15% in cash or in kind. The mechanism is intended only for low level technologies such as hand dug wells and spring protection. Communities are provided with training and where needed support is given during scheme implementation.



This study carried out by the Water and Sanitation Program-Africa and commissioned by the Government of Ethiopia in collaboration with the Embassy of Finland aims to undertake an independent study to evaluate the achievements of the Community Development Fund and to “recommend concrete and feasible measures to scale up the funding mechanism, or principles derived from it, in order to accelerate the expansion of water supply and sanitation services in rural Ethiopia”. The ultimate aim is to contribute towards increasing effectiveness of aid delivery and towards efforts to develop a single harmonized sector program that aligns donor financing with government systems, and accelerates progress towards the water supply and sanitation MDGs.

The study took place between October 2009 and February 2010 and involved detailed discussions with relevant stakeholders at all levels and a detailed survey of over 70 schemes in Amhara. This included 27 schemes financed under RWSEP (both pre and post CDF), with the remainder being a comparative sample of schemes built via the other major financing mechanisms (national Water and Sanitation and Hygiene)WASH program supported by the World Bank/ Department for International Development (United Kingdom), UNICEF WASH program, government block grant and Non Government Organisation (NGO)).

## **Findings**

The main findings are that:

- The RWSEP implementation rate has increased by up to a factor of 5 (from an average of 200 water points per year (1994-2003) increasing steadily, from 2003, to over 1000 water points per year in 2008/9). This equates to an average of over 70 schemes per CDF-Woreda per year.
- The technical quality of the facilities built is satisfactory and functionality rates for CDF schemes (94%) are above average for Amhara (estimated at over 75%)
- The level of expenditure on investments relative to operational costs and technical assistance has increased from 15% of the total expenditures in 2003 (pre-CDF) to 58% of total expenditures in 2009.
- Utilization of investment budgets has increased from an average of around 53% between 1998-2002 (pre-CDF) to close to 100% during the end of Phase III / start of Phase IV (compared to below 50% for other large donor programs).

It was also observed that:

- Extensive support is given by the program to building the capacity of the local private sector and on occasion transport and other services are provided directly to the communities where the private sector is not able to.
- Extensive support is given by the program to the Woreda governments in supervising and supporting the communities in technical and managerial matters, and to the regional government in all aspects of program financial management and oversight.

- Household sanitation and hygiene promotion is not systematically provided via the CDF mechanism as it does not involve construction subsidies.
- Water shortages are evident in some of the schemes – especially the hand dug wells.

### **Conclusions**

The study isolates 5 core factors related to the funding mechanism that can explain the success of CDF:

- Simplified accounting of funds
- Simplified procurement of materials and services
- Use of community based project management
- Use of specific technical and governance controls/safeguards
- Development of technical and governance skills in the communities

The first three factors above are the main contributors to the relatively swift implementation rate which, compared to other implementation approaches in Ethiopia, is the most impressive achievement of the Community Development Fund approach.

The direct transfer of funds to communities has led to removal of the main implementation bottlenecks of financial administration and procurement experienced in earlier phases of the program before adoption of the Community Development Fund. Simplified financial accounting has been achieved through outsourcing detailed accounting of the funds to a micro credit institution (ACSI) and the communities themselves (with back up support from the program). Simplified procurement has been achieved by allowing the communities to procure directly rather than using the more complicated and time consuming public sector and/or donor procurement procedures. Project management by the communities has been effective because the communities are focused on a single purpose, are highly incentivised to ensure completion of the works and, they are on site so can easily provide very close supervision.

At the same time, very effective controls have been put into place that ensure satisfactory technical standards, adequate cost control and discourage opportunist or fraudulent practices. In summary, the specific controls are:

- The communities account is opened and authorised by the Woreda Community Development Fund Board
- Disbursements are small (three or four instalments or less than USD 1000)
- Each withdrawal is authorised by the Woreda Water Desk
- Most payments are effected immediately after withdrawal from the bank
- Instalments require the community to show how funds have been used to date
- The unit price for most materials in the specific locality is known by Woreda officials
- The quantity to be procured is estimated by a technical person and is standardised

- Items are procured by the water and sanitation committee; not by individuals

The combination of simplifying accounting and procurement procedures together with the use of these specific controls is unique to the Community Development Fund and arises from the direct transfer of funds to the communities and the communities using the funds responsibly and effectively.

A further factor is that the transfer of funds to the communities places a direct responsibility on them for planning and implementing their water supply. In this way, technical skills and collective decision making are tested and enhanced and the community as a whole better prepared for the future maintenance tasks. They become familiar with management of funds, already have a working bank account, and are in close contact with local artisans that can help in more complicated maintenance tasks. In some cases the artisans train the communities in routine tasks and even in well digging. This factor contributes to the relatively high functionality rates.

The study also identifies a further 2 factors that are related to the background support provided by the programme itself:

- Pro-active capacity building of the private sector and where necessary substitution
- Pro-active capacity building of the public sector and where necessary substitution

The success of the CDF is also due to the willingness and capability of the programme to step in and provide services where the private sector cannot e.g. transport of materials and stocking of spare parts. The program recognises that substitution of the private sector role in this way is not sustainable and so, increasingly, the private sector is being supported and capacitated so that such direct intervention by the program itself is not necessary.

Support is also provided by the program to the Woreda, zonal and regional levels of government in their tasks of supervising and supporting the communities in technical backstopping as well as in the operations of the Community Development Fund Board. The program steps in to provide transport and makes available well trained staff to make frequent site supervision visits. Again, like for the support to the private sector, The program recognises that substitution of the public sector role is not sustainable so increasingly the emphasis is on capacity building and improving the management, budgeting and planning functions at zonal and Woreda level.

The special, if not unique, feature of the program is that it has the capability of directly substituting the private and public sectors when it appears that they are not able to undertake their tasks with capacity building alone.

The study also notes a number of supportive factors that help explain the success of the approach:

- Continuity and length of program support

- Longer term relationship built between public sector, private sector and donor
- Highly effective technical assistance
- The presence of a renowned and locally based credit institution
- Favourable geography that allows the use of simple low cost technologies

Continuous support from 1994 has meant that the capacity of the public and private sector in the CDF project Woredas of Amhara region has been significantly increased. The long and continuous period of support has created a long term relationship of trust between the donor, the public sector and the private sector. The quality rather than the volume of technical assistance has been a factor in capacitating local organisations and staff and in introducing innovations. The presence in Amhara of ACSI, which is a world renowned credit and saving institutions with offices in all Woredas, is a significant factor in the operational feasibility of the approach. Finally and perhaps mostly importantly, the presence of a favourable geography that allows the use of simple low-cost technologies (mainly hand-dug wells and sprig protections) has enabled the market for water services to work and for demand to be matched by supply, either through technical skills and material available within the community themselves, or within the limits of local artisans and providers.

Challenges to be addressed include:

- Development of a viable strategy for institutionalization of the CDF and the exit of direct program support in the medium term
- Ensuring that the CDF reaches, or complements other mechanisms with the ability to reach, highly marginalized communities
- Integration of environmental management into program design to strengthen year-round viability of water sources

The study points to a number of recommendations to further strengthen the CDF approach, including:

1. Promoting the use of the CDF mechanism for institutional sanitation, and ensure closer coordination between the water supply investments and household sanitation and hygiene promotion efforts;
2. Increase coordination between CDF interventions and the environmental and catchment protection activities of the agricultural sector to preserve and enhance water resources;
3. Complete the WASH inventory in all Woredas supported so far by the CDF, using the formats and processes developed under the WASH monitoring and evaluation system;
4. Continue to adapt the CDF mechanisms to different circumstances e.g. use of the mechanism for more complicated technologies; methods for delegation of procurement to Woreda for remote locations, etc;

5. Introduce the strategic Woreda WASH plan concept in all CDF Woredas, both to encourage Woreda-wide planning and as a basis for integration of CDF into a programmatic approach;
6. Through cooperation with other partners, ensure alternative mechanisms are available at regional and Woreda level for communities which are not suitable for use of the CDF mechanism (e.g. do not have adequate water resources for simple technologies or are not capable of managing a CDF intervention);
7. Update the CDF manual for inclusion in a later/future WASH program implementation manual;
8. Encourage the local procurement of hand pumps in order to further strengthen the spare parts supply chain;
9. Introduce formal annual auditing under the Woreda finance office to further strengthen internal controls;
10. Consider options for introducing rope pumps instead of hand pumps. This will tend to increase sustainability and by lowering costs bring subsidies more in line with government policy;
11. Withdraw direct program assistance on a step by step basis from those Woredas that have been supported longest and are the most prepared as a means of testing the longer term institutionalization of the approach;
12. Support the strengthening of the Regional WASH Coordination Office in order to facilitate a progressive transfer of program management responsibilities into the national WASH structure.

## **Part 2 – Mainstreaming the CDF Mechanism**

### **Challenges and opportunities for mainstreaming the Community Development Fund**

There are 3 potential sector scenarios within which there are opportunities for future mainstreaming of the Community Development Fund approach:

- Status quo – where a number of stand-alone approaches continue with some of them adopting the Community Development Fund mechanism where appropriate
- A harmonized “One WASH” program – based primarily around the current World Bank, British (DFID) and African Development Bank supported program, where the Community Development Fund mechanism could be incorporated as one of a number of financing options where conditions allow
- Sector budget support – use of government procedures and channelling of investment as a block grant to the Woredas where mainstreaming of the Community Development Fund mechanism may imply adjustment and additional flexibility in use of treasury funds

The main challenges lie in recognising that the Community Development Fund mechanism can only be used where:

- Geographic conditions allow simple technology (unless subsequent experience shows that communities can handle more complex technologies)
- Financial intermediaries are present at a density which implies that they have other tasks as well
- Communities are cohesive

In turn this means that the Community Development Fund mechanism:

- Can never be the only mechanism but will have to fit into a scenario where several mechanisms are possible
- Particularly for the sector budget support scenario, and for all scenarios in the long term, mainstreaming is dependent on whether government procedures are flexible enough to allow transfer of funds to communities via a financial intermediary

### **Rationale for mainstreaming**

The Universal Access Plan review, recent WASH Joint Technical Reviews and the current CDF evaluation study, point to a number of lessons learnt from use of the CDF mechanism that could assist Ethiopia in pursuing the Universal Access Plan and implementing policies on use of low cost technology and mass mobilization. There is strong evidence that the potential benefits of mainstreaming the CDF approach where conditions are suitable include:

- A rapid implementation rate due to simple procedures and community management
- Effective control of unit costs due to tight local controls/safeguards
- Higher efficiency in the proportion of funding used for physical investment
- High degree of functionality associated with higher community responsibility and skills

The features of the CDF mechanism that are contributing to these benefits with potential to be mainstreamed are:

- Transfer of funds to the community using financial intermediaries where appropriate
- Use of specific controls that allow adoption of simplified procurement and financial management procedures
- Use of community structures for project management
- Pro-active approach to capacity building of the private and public sectors

### **Potential approaches to mainstreaming**

Mainstreaming can take place in two ways:

- 1) CDF as a modality for rural water supply within the national WASH sector

The CDF modality can be introduced as one of an array of financing (and implementing) modalities in the national WASH approach so that where conditions are suitable, investment

funds can be transferred to communities via financial intermediaries. The CDF mechanism is particularly suitable as a mechanism under the WASH program where:

- Technology is simple enough to allow community management of implementation
- There are financial intermediaries with branches in close proximity to the communities
- Communities are cohesive

## 2) Adopting features of the CDF in other modalities

Lessons learnt from the CDF approach can inspire existing approaches to introduce simpler procedures, to transfer more responsibility to communities and to adopt a proactive approach in bridging gaps in private and public sector delivery systems. This would imply greater attention given to:

- Simplifying accounting and procurement
- Increasing direct community involvement in project management
- Introducing more flexible safeguards to compensate for simpler accounting and procurement
- Combining gap filling with capacity building of the private and public sectors where needed

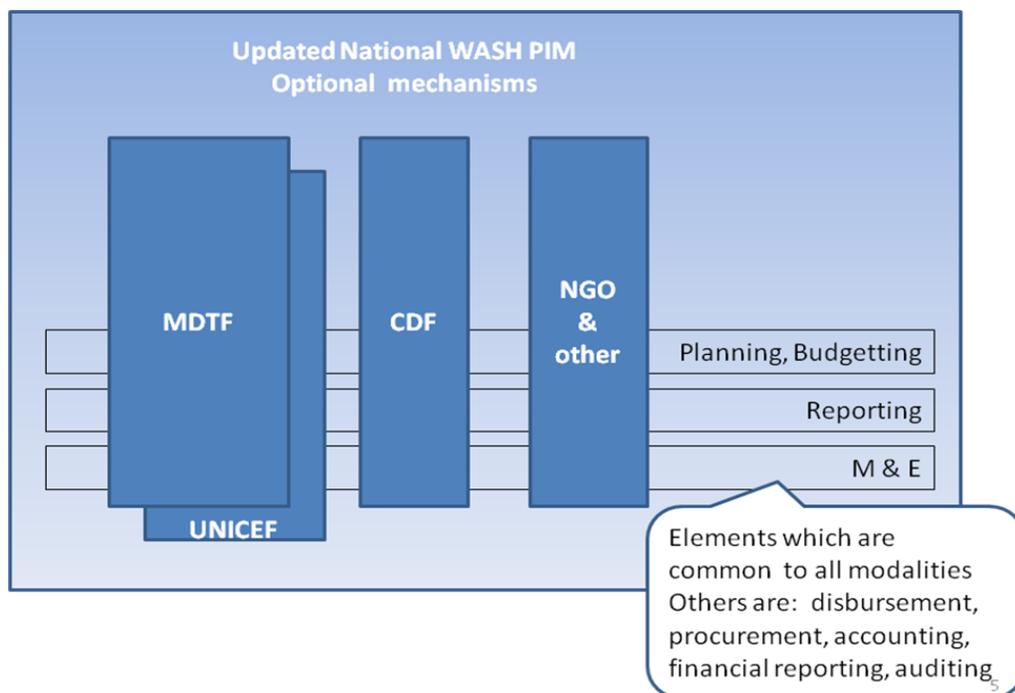
### **Mainstreaming strategy**

The mainstreaming strategy for CDF is linked to the overall effort of aligning all current modalities to the evolving Ethiopian national sector framework. The ultimate aim would be a national system that allows Woredas and regions to make use of:

- A community transfer finance and implementation mechanism for simple technologies and where other circumstances are suitable
- A government block grant finance and implementation mechanism for more complex technologies and in situations where this mechanism is preferable.
- NGO and other support finance and implementation mechanisms

The community transfer mechanism would be based on the CDF. The block grant system would be improved through the innovations tested and introduced by UNICEF and the Multi Donor Trust Fund. NGO and other support will in most cases not involve cash transfers to government but will pay directly for construction works (i.e. in kind). In all cases the mechanisms are a combination of finance and implementation procedures.

Making use of these 3 mechanisms will allow Woredas and regions to respond flexibly using tested strategies as illustrated below.



In the interim, before sector budget support becomes a reality, a close proxy to alignment can take place whereby donors channel their funds to Woredas and regions via their preferred mechanisms under the guiding umbrella of a WASH Programme Implementation Manual. Woredas and regions by developing Woreda strategic WASH plans will have a single plan, a single budget, a single report and a single monitoring and evaluation system. By saving resources and increasing coherence, a higher quality of planning, budgeting and reporting will result. For each scheme, Woredas and regions will, depending on the circumstances use either a community transfer mechanism (for simple technologies) or fully government managed mechanisms (where demanded by more complex modalities). They will thus, in principle, because of the geographic variation in their areas, be capable of using either.

Once the RWSP and FinWASH programmes come to an end, funds for the CDF mechanism will no longer be donor specific. Instead, donors (including Finland) would put funds in the MDTF and/or directly through the treasury and be free to earmark money for use by the community transfer mechanism. Or as and when it is deemed suitable, simply provide sector budget support allowing regions and Woredas to freely select between mechanisms depending on the circumstances and unconstrained by any limits imposed through earmarking.

The World Bank, African Development Bank and UNICEF projects effectively support the government managed mechanism using safeguards (mainly in procurement and financial management) and other adjustments/improvements to the national systems. Most Woredas would either be supported by one of the donors i.e. either the World Bank or African Development or UNICEF. Where possible, the safeguards and adjustments should be harmonised as there is little logic or benefit in having different procedures for the same task.

Intensive capacity building of Woredas, regions, communities and the private sector is a temporary task and in principle does need to be integrated into core government functions. In the long term there is a routine human resources development function that needs to be strengthened. There would be a benefit in coordinating intensive “one off” capacity building. This can be done at regional level under the umbrella of the Regional WASH Coordination. Capacity building instead of being directed through project vehicles could be assembled under the regional WASH coordination team using CDF and Woreda support group type approaches as well as providing more general water sector capacity building relevant for all modalities.

## **Recommendations**

- 1) The CDF should be mainstreamed into the national water sector framework so that it becomes a core modality available for all regions and Woredas where it is appropriate. In support of this the following actions should be taken:
  - National authorities lead by the MOWR and including the National WASH Coordinating Office and the Ministry of Finance and Economic Development should integrate the CDF mechanism into the national strategy for the rural water supply sector.
  - Re-consider capex subsidy levels (i.e. the proportion of the scheme not funded by the community) for rural water supply in order to harmonise to the extent possible the CDF approach with national strategy.
  - Update the current draft WASH Programme Implementation Manual in line with the Multi Stakeholder Forum undertaking in order to integrate CDF. The manual should be simplified where possible and should allow for: multiple modalities; improved coordination of capacity building efforts between modalities and; development of a single Woreda strategic WASH plan, budget and report that can serve all modalities.
  - Map the potential for adopting the CDF in other regions of Ethiopia (presence of favourable technologies and financial intermediaries, and using the present self supply mapping as a basis)
  - Withdraw intensive programme based support, step by step, from well functioning Woredas and transfer programme support, step by step, to new Woredas CDF in order to test if the CDF approach can be sustained once direct program support withdraws.
  
- 2) A mainstreaming plan with the following immediate and short to medium actions should be implemented.
  - Immediate actions:  
Action 1) In Amhara and Benishangul Gumuz: the regional government to discuss with UNICEF and MDTF donors, the scaling up use of CDF mechanisms and, if positive, then;

Action 2) Expand the mechanism to new Woredas and make the necessary support arrangements such as use of zonal advisers, extension of agreements with financial intermediaries, training and other back up.

- Short to medium term actions

Action 3) In other regions: the regional governments to make a policy decision on use of the CDF mechanism and discuss with UNICEF and MDTF donors on use of CDF mechanisms

Action 4) If the policy decision and discussions are positive then set up the necessary support structures and agreements with financial intermediaries – making use of assistance from Amhara and Benishangul-Gumuz where needed

Action 5) Regional governments that are interested to adopt the CDF mechanism as an option under the national WASH strategy to confirm procedures to be used for treasury funds, including whether the existing subsidy level (85%) should be used for treasury funds.

## **PART 1 – EVALUATION OF THE CDF MECHANISM**

### **SECTION 1: OVERVIEW AND OBJECTIVES**

#### **1.1.1 Background**

Over recent years, significant progress has been made towards improving access to water supply and sanitation services in Ethiopia, especially in rural areas. According to the UNICEF/WHO Joint Monitoring Programme, access to improved drinking water sources in rural Ethiopia has increased from 4 percent in 1990 to over 31 percent in 2006. Government data, which uses different definitions of access and of rural-versus-urban populations, shows a similar trajectory of growth in water supply access: from below 30 percent coverage in rural areas in almost all regions in 1998, up to over 54 percent for 2008/09.

Underlying this progress has been a significant increase in the scale of financial resources being channelled to the sector, both from government and donor sources. Recently, this has been documented in the Joint Budget Aid Review for the water and sanitation sector, conducted by the Ministry of Water Resources in 2008, and verified by the findings of a Public Financial Review undertaken by the World Bank in 2009. Both of these reports showed a strong upward trajectory in sector financing, especially during the last few years.

At present, this financing to the water supply and sanitation sector in Ethiopia is being channelled through a very wide range of different modalities. Rural water supply in particular is supported by many different combinations and permutations of development assistance, from national programs financed through government channels and using government implementation modalities, to localized interventions using innovative approaches and direct project financing mechanisms. Whilst much has been learnt through these diverse approaches, the challenge now is to consolidate lessons learnt, reduce fragmentation and dispersal of effort, and develop a coherent but also flexible approach. To this end, both government and donors have been actively working over recent years to improve the effectiveness of aid delivery. At present, this effort is focused upon transitioning towards a single harmonized sector program, as well as strengthening the alignment of donor financing with government systems and the national Universal Access Plan (UAP).

#### **1.1.2 The Community Development Fund**

One prominent financing mechanism in Ethiopia is the Community Development Fund (CDF), developed under the Finnish-Ethiopian bilateral Rural Water Supply and Environmental Programme (RWSEP) in the Amhara region. RWSEP has been supporting the expansion of rural water supply services in Amhara since 1994, although financing via the CDF mechanism came later, being introduced on a progressive basis between 2003 and 2006. Unlike other more

‘conventional’ government-managed funding arrangements, the CDF is a community-centred mechanism, by which the communities themselves are supported to initiate, plan, implement and manage their priority water and sanitation projects using funds that are transferred to, and managed by, the community. In 2008, Finland expanded CDF implementation to the Benishangul-Gumuz region.

In Ethiopia, RWSEP is widely regarded as having become a successful program, especially since the adoption of the CDF mechanism after 2003. Although previously this view was based largely on anecdotal evidence, recent studies have provided stronger additional evidence for the program’s claims that CDF enables relatively full utilization of budget, rapid implementation rates, and sustainable schemes (recorded in high functionality rates). Such studies include a comparative assessment of rural water supply financing mechanisms, undertaken by WSP as part of a recent World Bank Public Financial Review; and analysis conducted by the Ministry of Water Resources under a review of implementation strategies for the rural water supply Universal Access Plan.<sup>1</sup>

### 1.1.3 Objectives of the Study

On the basis of these positive findings, both the Ethiopian and Finland government authorities have expressed an interest in learning more about the performance of the CDF mechanism, with a view to identifying ways to mainstream the approach within the broader water and sanitation sector. As such, the Water and Sanitation Program (WSP)-Africa has been requested by the Government of Ethiopia, in collaboration with the Embassy of Finland, to undertake an independent study to evaluate the achievements of CDF and to “recommend concrete and feasible measures to scale up the [CDF] funding mechanism, or principles derived from it, in order to accelerate the expansion of water supply and sanitation services in rural Ethiopia”.<sup>2</sup>

The ultimate objective of this work, therefore, is to outline a feasible strategy via which the lessons from CDF can be mainstreamed, either through the integration of CDF principles within other financing modalities, or via the scale up of the CDF mechanism itself. First, however, it is necessary to understand more about the CDF mechanism: what has been its performance and, most importantly, **what factors are driving this performance**. This analysis will then be used as a basis for the mainstreaming strategy outlined in Part 2 of the report.

These underlying questions can be summarized as:

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<sup>1</sup> See “Which financing modalities work best for the water sector?” published in the *2009 World Bank Public Financial Review*, and the *Review of Rural Water Supply UAP Implementation and Strategy Reformulation*, conducted by the Ministry of Water Resources. The strong performance of the CDF has also been documented in a number of recent Joint Technical Review reports.

<sup>2</sup> See full Terms of Reference: *Scaling Up CDF for Accelerated WASH Coverage in Ethiopia*

- What is the performance of the CDF mechanism (i.e. is it really as good as the preliminary evidence suggests)?
- If so, what are the “ingredients of success” behind the CDF mechanism?
- And, therefore, what is the scope and recommendation approach for mainstreaming the CDF mechanism, or its key features, across the sector as a whole?

#### 1.1.4 Methodology

The methodology for the study was designed to address the first question above. In order to understand and evaluate the range of different factors underlying the performance of the CDF mechanism, a number of survey approaches have been developed for this study. These include:

- **Detailed background analysis** of data from the different phases of the RWSEP, with a focus on the long-term physical and financial performance of the program
- **Stakeholder interviews** designed to qualitatively assess perceptions of the CDF mechanism and factors underlying its comparative performance. This included government officials at all levels (federal, regional, zonal and woreda), CDF program staff, donors officials and staff of the local micro-financing institution (see Annex for list)
- **Water scheme assessment tool** designed to capture data on physical program outcomes, such as build quality, sustainability, and so forth, across a sample of both CDF and non-CDF financed schemes in the Amhara region. This also gave an opportunity to consult directly with community members on their experience with the CDF mechanism.

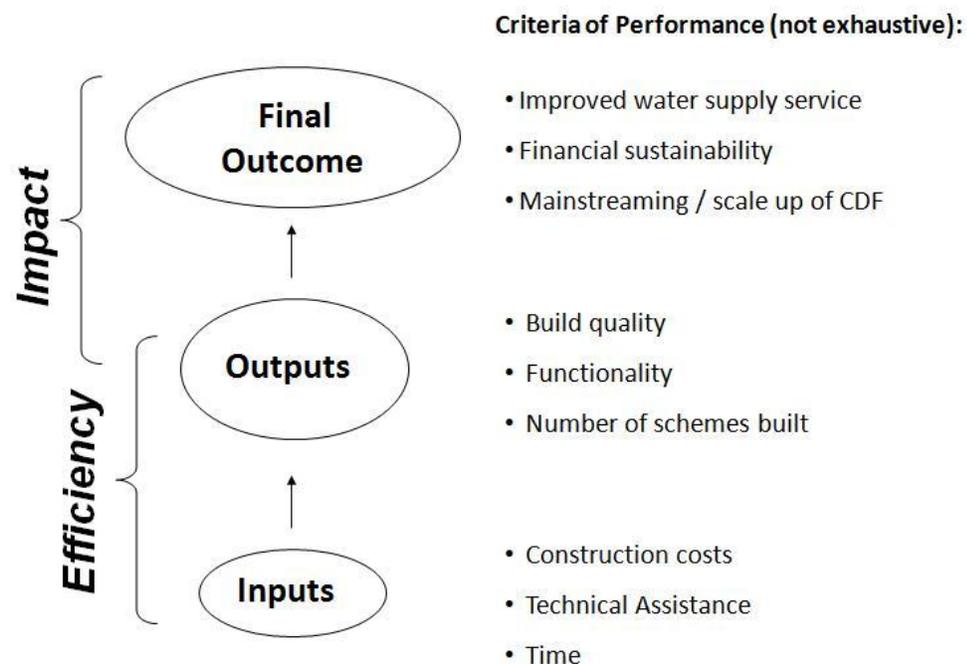
In terms of quantitative analysis, the data generated through the water scheme assessment and the background analysis have been used to generate a picture of how well the CDF mechanism is turning inputs into final outcomes, as conceptualized in Figure 1 below (following page). The figure describes some of the ‘criteria of performance’ that can be used to measure the efficiency and/or impact generated by the program’s measurable inputs, outputs and outcomes. However, the field work conducted for this study has also revealed that some of the features driving the CDF performance – such as “community empowerment” for example – are largely intangible and therefore difficult to quantify. Therefore, throughout the report the data analysis is combined with the qualitative findings from the stakeholder consultations, which revealed a lot of information about how the CDF mechanism was working in practice.

For the water scheme assessment, the aim was to evaluate a sample of 25 schemes financed under RWSEP, and another 25 schemes financed under other mechanisms as a basis for comparison. However, in order to capture a broad range of schemes from other financing mechanisms, the sample was ultimately increased to a total of 75 schemes, including 27 financed under RWSEP (including both pre-CDF and post-CDF).

The schemes surveyed were taken from a number of different woredas, which were selected to ensure that all major financing modalities were captured. For RWSEP woredas, an effort was made to select woredas performing both above and below average in relation to annual scheme implementation rates. On this basis, woredas selected were Yilmana Densa, Gonji Kolala, Bahirdar Zuria, Bubign (all using CDF), Machakel, Denbecha, Debre Elias and Dejen.

Efforts were made to select schemes at random on the basis of inventory lists at woreda level, with particular account taken of ensuring a wide spread in terms of scheme age. It is important to note that the earliest schemes financed under CDF were in 2003, and therefore this represented the limit in terms of age of the CDF schemes sampled. The sampling process also took some account of geographic distribution and accessibility, although any resulting positive bias from this is common to all schemes sampled. Lastly, it should be noted that there is always an inherent positive bias in such surveys, since older failed schemes tend not to be recorded in current inventories.

**Figure 1: Metrics of Performance for Measuring the Impact of the CDF Model**



For both the scheme survey and stakeholder consultations, the analysis focused on the performance of the CDF mechanism in Amhara, under RWSEP. Although the CDF has recently been scaled up to Benishangul Gumuz, it is currently too early to assess the results of the new program there. Nevertheless, the evaluation has looked into the progress in Benishangul, particularly in relation to the experiences during the start-up phase, which are very useful for understanding the potential opportunities and barriers to introducing the CDF elsewhere.

## **SECTION 2: THE CDF MECHANISM AND OTHER FINANCING MODALITIES**

There are currently a wide range of different modalities being used to finance the development of water supply and sanitation services in Ethiopia. Therefore, while the CDF mechanism remains the focus of this study, it is also important to understand how it fits within the broader context of sector financing. This will serve both to understand the comparative performance of the CDF mechanism (i.e. how does it compare to other programs with similar objectives) as well as to begin to assess the potential for mainstreaming the approach. Inevitably, the latter is highly dependent on the financial and institutional context in the water and sanitation sector in Ethiopia, both current and anticipated.

As such, this section will begin with a detailed overview of the CDF mechanism: how it has evolved, and how it works. This will incorporate background on RWSEP, since in a number of areas “CDF” can only be understood and evaluated within the context of the program under which it was developed.

This will be followed by a brief overview of the other major financing mechanism responsible for developing water and sanitation infrastructure in Ethiopia. In many cases these are referred to as “WASH” programs (Water Supply, Sanitation and Hygiene), although, like under CDF, the development of water supply infrastructure is generally the primary focus, particularly in terms of investment financing. The three financing modalities that will be discussed are: (i) the Government Block Grant, (ii) the national WASH program; (iii) and the UNICEF WASH program. A full overview of each of these modalities is provided in Annex 1.

It should be noted that this excludes other financing mechanisms that also impact on the water and sanitation sector. For example, there are initiatives that include water and sanitation financing as part of broader multi- or cross- sector development efforts: notable examples include the government Food Security program and the multi-donor Productive Safety-Net Program. However, although significant in financial terms, since these programs are not designed primarily for the purpose of delivering water and sanitation services they are less relevant for the purpose of comparative analysis. Likewise, Non-Government Organizations (NGOs) are also providing substantial financing to the sector, but it is difficult to make direct comparisons with CDF due to the wide variety of different implementation arrangements being used.

### **1.2.1 The CDF Mechanism**

#### *How has it evolved?*

Although the Government of Finland has been providing funding through RWSEP since 1994, the CDF mechanism is a relatively recent innovation, having first been introduced in 2003/04

during the third phase of the program. During Phase I (1994-98) and Phase II (1998-2002) the focus of RWSEP was on capacity building across the various levels of government, beginning at the regional level and then graduating down to governments at zone and woreda level. This was in line with the standard development approaches that have tended to be used in Ethiopia, in which implementation and finance is managed directly through the decentralized government system.

During this time, the role of the community was limited to participation in planning and the supply of local materials and labour. However, there appeared to be frustration with the progress made via this approach, in particular due to the fact that under local government leadership, implementation rates suffered from the slow and bureaucratic procedures necessary for government-led construction and financial management.<sup>3</sup>

In response, the CDF mechanism was progressively introduced under the third phase of RWSEP, beginning in two program woredas in 2003/04 and reaching all 14 RWSEP woredas by the end of the 2006/07 financial year. The introduction of the CDF represented an attempt to enable and capacitate communities to manage the scheme construction process, and thereby also circumventing the challenges created by the bureaucracy and limited capacity of local government.

### ***How does it work?***

At its core, the CDF mechanism is an approach designed to place communities at the centre of the water scheme development process. Traditionally in Ethiopia, as was the case under the early phases of RWSEP, the development and maintenance of such infrastructure is considered to be primarily a government responsibility. More recently, there has been a shift towards contracting-out of water scheme development to local artisans and private companies, and towards encouraging communities to take responsibility for their own operation and maintenance. The major innovation of the CDF mechanism has been to take this a stage further, and to transfer the funds for physical construction directly to the communities and, in that way, make communities themselves responsible for the full development process, through planning, implementation (including procurement of most materials<sup>4</sup> and labour) and maintenance. This means that there is no “handing over” of the scheme to communities, since the project has been implemented from the start by the community itself. In theory, the role of the government is limited under this approach to administration, facilitation and training. This process is summarized in Figure 2 below.

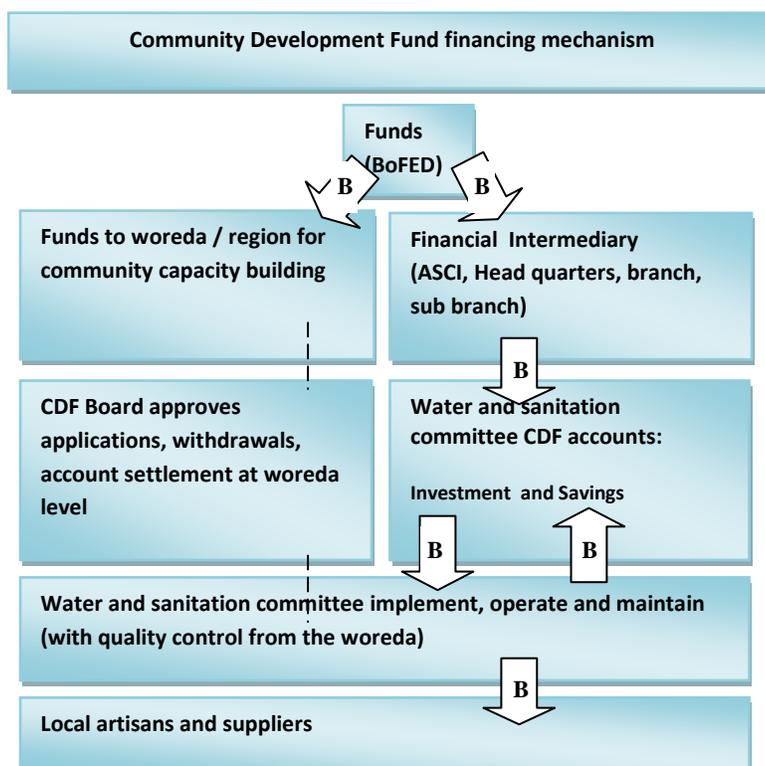
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<sup>3</sup> A. Suominen and M. Urgessa (2004), Community Development Fund Approach in RWS Financing, WEDC 2004.

<sup>4</sup> In most cases, hand pumps are being procured directly by the woreda with finance provided directly by the program. In certain cases (e.g. Bahir Dar Zuria woreda) where there are accessible suppliers, hand pumps are procured directly by WASHCOs.

**Figure 2: CDF Financing Approach**

The program literature highlights the primary advantage of such an approach as creating an increased sense of ownership amongst those who ultimately benefit, thereby helping to ensure that resources are used effectively in the first place, and improving the chances that the intervention will be sustained once the external support is removed. It is also argued that such an approach has the potential to empower communities more broadly, giving them the resources, skills and information they need to manage their own facilities in the longer term. Indeed, consultations held for this study suggest that the principle of ‘community-management’ does seem to be gaining ground in Ethiopia, and it appears that programs such as the CDF are helping to dispel the “myth” that communities do not have the capacity to manage the funds for such development processes for themselves.



The key defining and perhaps only truly unique feature of CDF is the financial flow mechanism, which enables resources to be channelled directly to communities. An innovative financing approach has been adopted under CDF, whereby investment funds for water scheme development are channelled to community-managed accounts held by a local micro-finance intermediary. In the case of RWSEP, the Amhara Credit and Savings Institute (ACSI) is used for this purpose. With 185 sub-branches across the region, ACSI offers a geographically dispersed mechanism to channel financial resources directly to communities, rather than via the government system. In Amhara, RWSEP has also benefited from the fact that ACSI is a well established institution with relatively high financial management capability (including between 10-12 staff in each sub-branch), which provides an additional capacity-related advantage versus using a traditional government-managed approach.<sup>5</sup>

<sup>5</sup> In 2007 Forbes magazine rated ACSI 6<sup>th</sup> out of a field of 641 micro-credit providers. The rankings were based on a weighted index which included the portfolio size, quality, and return, as well as the efficiency of the organization. It was the highest ranked African institution on the list and well above the Dedebit Credit and Saving Institution, the second highest ranked Ethiopian institution in 31<sup>st</sup> place.

Given the apparently strong performance under RWSEP since the CDF mechanism was introduced, it would be appealing to immediately conclude that the improved results have been a direct product of these innovations. However, there are other features of RWSEP – but not necessarily features of the CDF mechanism – that also appear to have had a significant influence on performance. This will be discussed in detail in Section 3 below, but for now it is worth highlighting some of these factors.

Firstly, and perhaps most importantly, under RWSEP the CDF mechanism is being supported by quite a comprehensive and intensive package of capacity building and technical assistance. Either directly (through program staff or use of program vehicles and equipment for transport of goods to sites) or indirectly (through trainings and increased operational budgets) RWSEP funding is providing significant backstopping to government at all levels (regional, zonal and woreda); to communities in their various CDF-related functions; and to the private sector.

A further important feature is the current focus on the development of water supplies through low-cost technologies, in particular hand-dug wells. Such technologies are well suited to the hydrological conditions in many parts of Amhara, and the less complex nature of the material and labour procurement processes lend themselves well to community management. It does also mean, however, that the CDF mechanism is targeting the “low hanging fruit” and therefore may be expected to achieve better results than other approaches that are also tackling higher-technology schemes in more challenging hydrological environments.

Another feature of RWSEP that has undoubtedly impacted on performance is the continuity and length of the program (RWSEP has now been running for over 15 years). This has impacted

#### Box 1: Hygiene and Sanitation under RWSEP

The Government of Ethiopia has been very progressive in its efforts to promote the integration of water supply, sanitation and hygiene (WASH) interventions throughout all water and sanitation programs in the country.

In this regard, the focus of this study primarily on water supply requires some clarification. Under the CDF mechanism during Phase IV of RWSEP, the primary use of investment finance is for the development of community *water* schemes. This is fully consistent with the policy of the government, which states that sanitation facilities should not be subsidized at household level. It is worth noting, however, that under Phase III of RWSEP the CDF mechanism was also used effectively to finance construction of institutional sanitation facilities in schools. The evidence from this appears to have been positive, and therefore the option of using the CDF mechanism for the purpose of improving water and sanitation at an “institutional” level (in schools and health facilities) should remain open in the future, with Parent Teacher Associations to act as WASHCO equivalents.

Furthermore, while investment finance under CDF is focused on water supply, the importance of integration of sanitation and hygiene interventions is reflected in the current RWSEP design. Again, in line with government policy sanitation and hygiene investment are focused on promotional activities, and funding for this purpose is channelled through the Amhara Bureau of Health under the capacity building window of RWSEP. In practice, however, the evaluation found limited evidence that such promotional work was being coordinated with investments in water supply, and therefore identifying methods to strengthen such integration more directly under the CDF mechanism may be a valuable area for further attention in the future.

current performance in many ways, including: the strong knowledge of program processes amongst all stakeholders; the fact that such processes have been progressively adapted over time to local conditions; and the strong relationships and high level of trust that has been developed between all engaged partners.

A final feature of CDF that should be discussed here is the nature of the demand-responsive approach. Much of the program literature highlights the fact that financing is “demand-driven”, since communities are required to submit an application for funding and raise a 15 percent contribution towards the total investment cost. In reality, there may be a need to qualify this assertion. Firstly, the application process is driven both by a high degree of promotional work and is backstopped through technical assistance provided by woreda staff. Secondly, the 15 percent contribution is primarily in-kind, with cash contributions normally in the range of 1,000 Ethiopian Birr, or around 3 percent of investment costs.<sup>6</sup> This is not to diminish the achievement of RWSEP in this area: cash and in-kind contributions remain high relative to other programs, and there also does appear to be a genuine and growing demand for CDF resources from communities based on its demonstrated results.<sup>7</sup> Nevertheless, it is important to acknowledge that a degree of ‘demand-creation’ has been necessary, and that this feature of RWSEP is perhaps less relevant than the more significant innovations discussed above.

### **1.2.2 The National WASH Program**

The national WASH program is currently the closest there is to a harmonized pooled funding mechanism for the water, sanitation and hygiene sector in Ethiopia. The program has evolved out of the World Bank financed Water Supply and Sanitation Program (WSSP), which began in 2004 with a US\$100 million specific investment loan (including grant component) to the Government of Ethiopia. Around 60 percent of these funds were targeted at rural areas, with the remainder targeting small and medium sized towns under a separate ‘urban’ component. The WSSP adopted a similarly progressive approach to capacity building at federal, regional, woreda and community level, although in a much more condensed timeframe than under RWSEP and across all Ethiopia’s regions. At the community level, the program has supported the establishment of WATSAN Committees and the development of scheme management plans, and therefore ensuring the capacity of communities to operate and maintain their water and sanitation infrastructure is a key component of the program. However, in line with the current standard government approach, the responsibility for implementation and the associated management of investment finance remains with the government: either regional (in the case of more complex schemes) or woreda (in the case of simple schemes).

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<sup>6</sup> Furthermore, this is reserved for operation and maintenance, not used for the purpose of up front capital investment.

<sup>7</sup> This also appears to be the case in Benishangul Gumuz, where large numbers of communities have applied for CDF resources, many of which having already raised upfront contributions of around 1000 ETB.

In 2006, the WSSP was scaled up through a US\$62 million grant financed by the African Development Bank (ADB), specifically for rural water supply and sanitation. Although a separate project in administrative terms, the ADB program adopted the same implementation and financial management arrangements as under the World Bank program, and therefore represented a first small step towards harmonization in the sector. In 2007, the WSSP was scaled up even more substantially with a GBP 75 million grant (equivalent to US\$125 million) from the UK Department for International Development (DFID). The DFID finance was channelled directly to a new World Bank managed Multi-Donor Trust Fund, established to allow the pooling of DFID and World Bank resources, and to provide a mechanism for future harmonization in the sector.<sup>8</sup> Around this time, the WSSP became re-branded as the “National WASH Program”, in part due to the commitment of DFID to earmark a significant share (approximately 15-20 percent) of their funding to sanitation and hygiene promotion, and in part due to a growing shift towards integration of water supply with sanitation and hygiene in Ethiopia.<sup>9</sup>

This collective program of the World Bank, DFID and (to a lesser extent) ADB now represents by far the most substantial pool of investment finance available for water supply and sanitation in Ethiopia, and therefore the future evolution of this program will be critical in shaping the landscape of sector financing over the medium term.

### **1.2.3 UNICEF WASH Program**

Under their Country Program Action Plan, UNICEF is currently financing a 5-year WASH program over the period 2007-11 inclusively. The program is implemented in partnership with the Ministries and Bureaus of Water Resources, Health and Education under their tri-partite memorandum of understanding.

According to the Country Program Action Plan, over the current 5-year period the UNICEF program is targeting a total allocation of around US\$114 million for its WASH program. However, budgets are based on aspirations and depend on fundraising success, and therefore this level of funding will not necessarily be achieved in practice. This also creates challenges in terms of assessing whether implementation rates are constrained by utilization rates or by lack of fund mobilization. At present, disbursements are in the region of \$US 15 million per year.

Unlike the other programs discussed above, only a relatively small proportion (around 30 percent) of this funding is aimed at community water supply. The remainder is spread across community sanitation and hygiene, integrated WASH in schools and health institutions,

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<sup>8</sup> However, to date no further donors have joined the fund.

<sup>9</sup> This was catalyzed, in particular, by the engagement at the time with the EU Water Initiative, which helped to promote the principles of integration as well as harmonization and alignment. The use of “National” WASH Program also reflected the large increase in the size of the program as well as the ambition for it to become the central donor pooled funding mechanism for investments in water supply, sanitation and hygiene in Ethiopia.

emergency preparedness and response, and capacity building. As such, UNICEF has tended to be a lead partner on issues related to institutional WASH and integration across the WASH sub-sectors.

The UNICEF WASH program channels funds to regional governments for implementation by regional, zonal and woreda water offices. On the water supply side, the focus is on the development of shallow wells fitted with hand pumps procured by UNICEF. Funds must be utilized and fully accounted for before replenishments can be made, which has proved a particular challenge requiring high levels of support from program officers based in the regions.

In terms of harmonization, UNICEF is more constrained than many donors by virtue of its own funding arrangements: it is itself financed by a number of different donors, each with different financing agreements, timelines and requirements. This may restrict its ability to pool funds or to rapidly adapt its implementation approach. However, the program staff are keenly aware of these challenges and are actively engaged in both internal and sector discussions on WASH harmonization.

#### **1.2.4 Government Block Grant**

In Ethiopia, the Block Grant is the core fiscal mechanism for channelling budgets through the decentralized federal system.<sup>10</sup> Block grants are channelled from the Federal Government to Regional Governments on the basis of an agreed formula. A proportion of these grants remains with the region (“regionally-managed expenditure”) while the remainder is transferred again down to the local woreda level (“woreda managed expenditures”), again on the basis of pre-agreed formulas by regional assemblies. The purpose is to provide funding for both recurrent and investment costs, although in practice, due to the limited nature of treasury resources, capital budgets from the Block Grant remain limited, especially at woreda level.

The Block Grant is financed through government revenues and via the Protection of Basic Services (PBS) program, a donor-financed pooled fund designed to provide additional core resources for the basic service sectors. The PBS program funds around one third of the total Block Grant. An interesting recent innovation under PBS is the development of a Local Investment Grant (LIG), which will be used to finance capital investment in basic services (including water and sanitation). The LIG has been designed as a performance-based grant to woredas that have demonstrated sufficient capacity and accountable planning for capital investments. Under the LIG, the flow of funds follows existing arrangements for the federal block grant, uses existing rules for disbursement, and is fully synchronized with the Ethiopian fiscal year. As such, the financing mechanism developed under the LIG is much closer to a fully

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<sup>10</sup> The block grant is a constitutionally mandated entitlement for each Regional Government and is determined by a legislated formula that is largely based on equity considerations (population, income, level of development).

aligned sector budget support program than the current sector financing arrangements in the water and sanitation sector. However, the LIG has only just begun the pilot stage and therefore it may be some years before the concept could be applied as the primary financing modality for the water and sanitation sector.

Table 1 on the following page attempts to capture some of the major strengths and weaknesses of the different financing mechanisms currently being used to fund water, sanitation and hygiene in Ethiopia.

**Table 1: Summary of Major Strengths and Weaknesses of WASH Financing Modalities**

	CDF		National WASH		UNICEF		Block Grant	
	Strength	Weakness	Strength	Weakness	Strength	Weakness	Strength	Weakness
<b>Scope of Program</b>	WASH	Less integrated than some donor programs	WASH		WASH			Less integration with sanitation and hygiene
<b>Coverage</b>		Regional - 14 Woredas	National - over 200 woredas		National - over 100 woredas		National - all woredas	
<b>Program implementation</b>	Highly effective, community managed		Implementation arrangement at all levels in place	Most activities regionally implemented	Government structures	Only public enterprises implementing physical works (often delayed)	Sector offices	Limited private sector involvement
<b>Budget Allocation</b>	Available when required	Still to integrate into national accounts	Annual and becoming predictable with shift to IFR	Woreda level information limited	Annual, predictable	Woreda have no information	Annual, predictable	Capital budget very limited
<b>Planning</b>	Transparent, woreda involvement very high	CDF-specific; lack of woreda-wide planning	Transparent, woreda-wide plan		Activities linked to budget	Woreda have limited information	Transparent	Capacity aspect neglected
<b>Fund Flow</b>	Rapid, innovative and flexible	Outside of mainstream regional-woreda fund flow	Using government structures	Challenging liquidation requirements	Using government structures	Challenging liquidation requirements	Using government structures effectively	
<b>Utilization</b>	Very high			Challenging	<i>Unclear due to use of predicted budgets</i>		Very high	
<b>Procurement</b>	Decentralized to community level and effective	Requires strong program support	Strong control mechanisms, economy of scale	Centralized at region; delays	Quality assurance, economy of scale	Donor managed; lack of capacity building	National procedures	Limited testing due to capital constraints
<b>Capacity Building / TA</b>	Strong support for public and private sectors	Risk of substitution; challenge of exit	TA at all level, strong local private sector involvement	Mobility of WASH team	Decentralized program support	Risk of substitution; challenge of exit		Limited human resource capacity

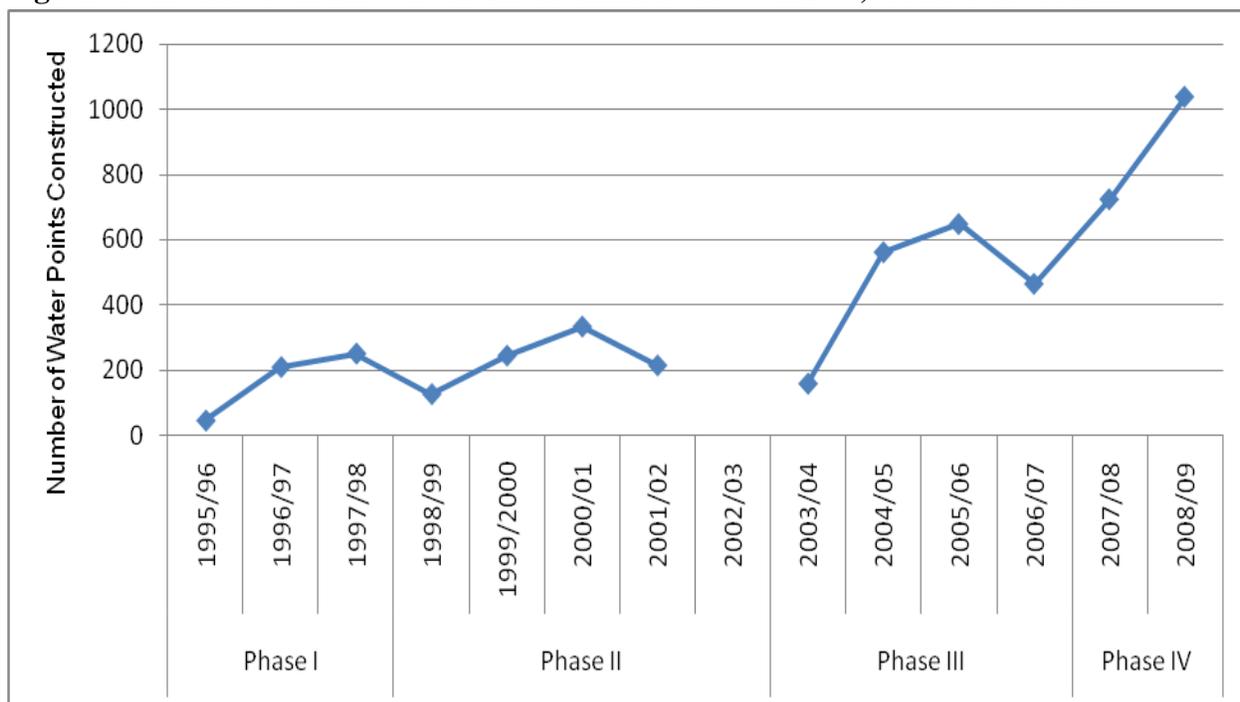
## SECTION 3: EVALUATION OF THE CDF MECHANISM

### 1.3.1 Performance of the CDF Mechanism

#### *RWSEP Performance Pre- and Post-CDF*

The introduction of the CDF mechanism under RWSEP between 2003 and 2007 coincided with a substantial increase in the rate of scheme construction under the program, as shown in Figure 1 below. The graph clearly demonstrates the sharp increase in physical progress from the third phase of RWSEP onwards: until 2003/04 the highest annual achievement was the construction of 335 water points, compared to an average of close to 700 water points per year between 2004/05 and 2008/09. At current rates, this equates to an impressive average of over 70 schemes per year for CDF-financed woredas.<sup>11</sup> Understanding the factors underlying this shift is one of the major objectives of this report.

**Figure 1: Number of Water Points Constructed under RWSEP, 1995/96 to 2008/09**



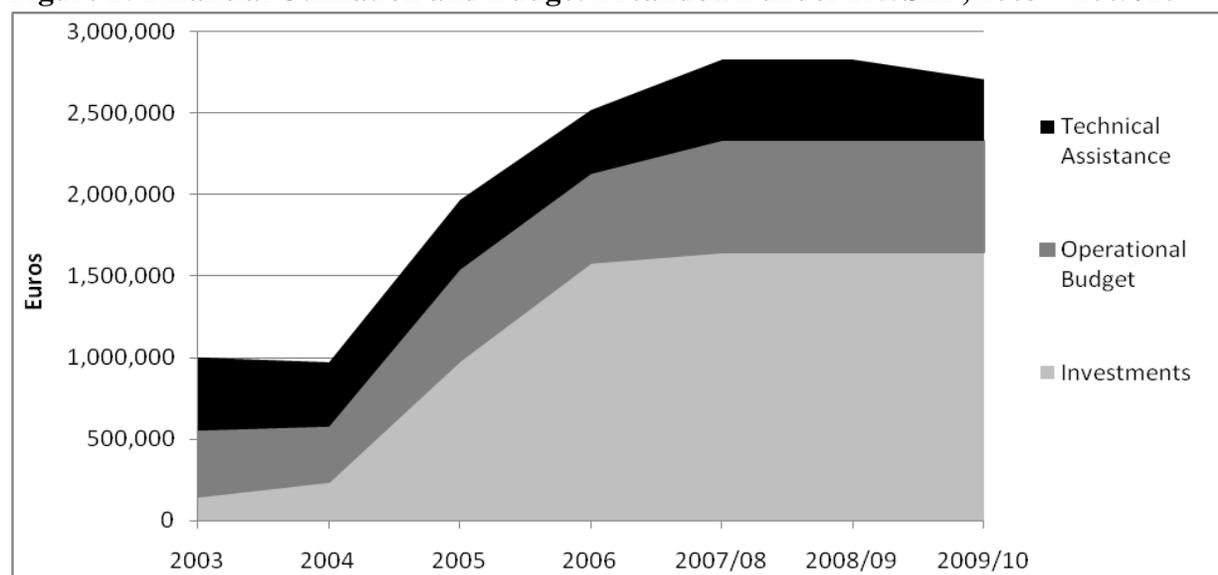
The first important observation is that this increase has been driven primarily by an increase in the flow of investment finance, rather than a reduction in investment costs per scheme. This is reflected in Figure 2, which demonstrates how the increase in implementation rates correlates closely with the substantial rise in investment finance from 2004 onwards.<sup>12</sup> Measuring

<sup>11</sup> It is important to reiterate that the CDF mechanism is primarily being used to finance simple, low-technology schemes, which should be taken into account when comparing implementation rates between programs.

<sup>12</sup> For Phase III (2003 to 2006) amounts correspond to actual utilization, as reported on a calendar year basis. For Phase IV, a corresponding breakdown is only available for budgets and therefore the graph uses budget data as

investment costs per scheme is problematic, since reporting periods for physical and financial performance under Phase II differ between calendar years and financial years. However, taking an average across Phase III and Phase IV shows a very consistent per scheme investment cost of around Euro 1,900. Since the inflation rate has been higher than the rate of currency depreciation, this represents a small increase in cost efficiency in real terms over this period. It also clearly represents a substantial fall in total expenditure per scheme, since operational and technical assistance budgets have remained fairly consistent over this time, and therefore their relative cost per scheme has fallen substantially.

**Figure 2: Financial Utilization and Budget Breakdown under RWSEP, 2003 – 2009/10<sup>13</sup>**



What underlying factors were responsible for the substantial rise in investment finance under RWSEP from 2004 onwards? To some extent, this appears to have been the result of a natural growth in investment budgets (and related absorption capacity) over the life of the program. Table 1 below shows the total Government of Finland budget and utilization over the four phases of the program in Amhara.

In addition to the overall growth in finance, during the earlier phases the focus on building capacity was high relative to physical output objectives. For example, during Phase II only 2.2 million Euros were invested in rural water supply (37 percent of the total Government of Finland budget for Phase II) compared to 4.9 million Euros budgeted for Phase IV (55 percent of total Government of Finland budget for Phase IV). This difference also represents an increasing focus

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reported on the basis of budget years (2007/08 to 2009/10). Since budgets and utilization rates have been quite consistently similar under RWSEP these trends are expected to closely reflect actual utilization.

<sup>13</sup> Note that 2003-2006 data relates to expenditure, while 2007/08 onwards is budget data. Since budgets have closely correlated with expenditures under Phase IV it can be assumed that these figures closely correspond to actual expenditures. The graph is also adapted for the shift from calendar year to financial year budgeting after 2006.

on rural water supply infrastructure during the evolution of the program: during earlier phases the scope of the program was much broader, including a greater share of financing for sanitation (including significant capital investments) and for environmental sustainability (which included fairly broader objectives such as afforestation and food security).

**Table 1: Growth in Budgets under RWSEP**

Phase of RWSEP	Total (Euros) <sup>14</sup>		Comments
	Budget	Actual	
Phase I (1994-98)	4,416,667	4,358,579	Fully utilized – primary for capacity building
Phase II (1998-2002)	6,162,574	6,044,328	Six month extension required to utilize budget
Phase III (2003-06)	8,110,000	7,965,861	Utilization close to 100 percent
Phase IV (2007-11)	11,270,000		Utilization on track

However, although overall budget trends played a role, they cannot explain the full extent of the increase in physical outputs and investment rates shown in Figures 1 and 2 above. A more revealing pattern emerges when we look at the utilization rates over time. During Phase II of RWSEP, when funds and implementation were still being managed at the woreda level, there was a consistent under-utilization of investment, from 32 percent in 1998/99 up to 68 percent in 2001/02 (an average of 53 percent over the 4 years). This required a 6-month extension of Phase II in order to utilize the remaining resources. Utilization rates during the early phase of Phase III were also low, although to what extent is less clear, since budgets for this phase are not readily available on an annual basis. This, together with the evidence of the rate of increase in investment expenditure when CDF was introduced (as shown in Figure 2 above), certainly supports the conclusion that utilization of investment funds has been significantly expedited under CDF. This is further supported by data for Phase IV, which shows close to 100 percent utilization of available investment funds during the first two years.<sup>15</sup>

This data supports the general views solicited during preparation of this study. For example, the RWSEP Team Leader during Phase III identified the management of materials and finance by the woreda as the major bottleneck prior to the introduction of the CDF mechanism.<sup>16</sup> This point was reinforced through discussions with program and woreda staff members, who noted that the

<sup>14</sup> Exchange rates have fluctuated throughout this period. For example, for Phase III a rate of 1 Euro = 7.5 ETB was used in the program document. This increased to 1 Euro = 11.4 ETB at the start of Phase IV. At current rates, the rate is upwards of 1 Euro = 15 ETB. However, in real terms the increase in funding under RWSEP due to the depreciation of the Birr has been largely offset by high inflation during this period.

<sup>15</sup> By comparison, according to the World Bank Public Finance Review (2008 data), utilization rates for other mechanisms are: Block Grant, 90%; World Bank, 42%; ADB, 27%; UNICEF, 30%. The PFR study also confirmed the close to 100% utilization rates for CDF. It should be noted that it is unclear whether the low utilization rate for UNICEF is due to actual slow utilization or due to over-estimated budgets.

<sup>16</sup> Phone interview with Arto Suominen (RWSEP program manager up until 2008)

shift to community fund management greatly reduced the burden of finance and procurement procedures, and thereby led to much more rapid utilization of investment finance under the program.<sup>17</sup>

This is certainly not to say that the introduction of CDF was a “silver bullet”. Table 2 presents the construction rates by woreda between 2003/04 and 2008/09, with the highlighted numbers showing when implementation began via the CDF mechanism. The table shows how for some woredas the shift to CDF corresponded with a rapid increase in construction rates, while for others the impact was much less discernable. In some cases, this was apparently due to initial resistance amongst woreda officials to the introduction of a new system that appeared to reduce their own authority. Farta woreda was highlighted as such an example, and the figures in the table show how this corresponded with stagnation in construction rates in this woreda even after CDF was introduced.<sup>18</sup> It appears that this has also been a challenge under the new program in Benishangul Gumuz, where there has been some resistance amongst government entities to channel funding directly to the communities. Table 2 also shows that there continues to be a wide variation in construction rates across woredas, suggesting that woreda capacity and attitude continues to play a large role in the effectiveness of implementation under RWSEP.

**Table 2: Relationship between shifting to CDF and the number of water points constructed**

Number of Water Points Constructed by Year						
Woreda	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Gongi Kolela					56	90
West Essie					29	42
Quarit	19	44	38	36	57	71
Bibugn		28	50	13	43	45
Enebsie		64	32	28	32	35
Dera	11	33	29	31	48	52
Fogera	17	55	38	37	50	106
BDZ	15	43	42	45	53	91
Ankesha	12	27	49	53	75	69
Farta	11	29	41	26	37	60
East Estie	16	39	48	35	33	39
D/Damot	18	44	92	34	38	107
Y/Densa	28	97	112	110	120	144
Guangua	16	47	74	37	60	87
<b>Total</b>	<b>163</b>	<b>550</b>	<b>645</b>	<b>485</b>	<b>731</b>	<b>1038</b>

*Highlighted numbers represent years when implementation was via CDF*

<sup>17</sup> The impact of this, and how it was combined with a shift to specific technical and governance controls, is discussed further in the ‘ingredients of success’ section which follows.

<sup>18</sup> Phone discussion with Arto Suominen (previous RWSEP team leader).

To summarize, the evaluation of the performance of RWSEP prior to and following the introduction of the CDF mechanism reveals some major positive trends:

- Implementation rate has increased by up to a factor of 5: average of 200 water points per year (1994-2003) to over 1000 water points per year (2008/9). Rate is currently over 70 schemes per woreda per year on average.
- The level of expenditure on investments relative to operational costs and technical assistance has increased from 15% of the total expenditures in 2003 (pre-CDF) to 58% of total expenditures in 2009.
- Utilization of investment budgets has increased from an average of around 53% between 1998-2002 (pre-CDF) to close to 100% during the end of Phase III / start of Phase IV.

### *Scheme Level Performance of CDF*

As outlined in Section 1, the study included a survey of 75 schemes constructed via financing from RWSEP (both pre- and post-CDF) and, for the sake of comparison, via a range of other financing mechanisms, including the national WASH program, the UNICEF WASH program, Government block grant, and NGO funded schemes.

The overarching finding of the scheme survey was that management of funds by community under CDF is not leading to poorer outcomes in terms of build quality, functionality and sustainability. In fact, against a number of indicators, the CDF financed schemes were performing above average for the sample, although care should be taken in extrapolating this conclusion for the mechanism as a whole due to the size of the sample. Irrespectively, the fact that community management was not leading to any identifiably poorer outcomes, while certainly resulting in rapid implementation and high utilization of investment finance, is an important finding in favour of the CDF mechanism.

More specifically, some of the highlights of the data from the scheme survey are as follows:

- The technical quality of the facilities built is satisfactory and functionality rates for CDF schemes (94%) are above average for Amhara (estimated at over 75%) and compared to the non-CDF sample (89%)<sup>19</sup>
- Financial sustainability is satisfactory with 75% of schemes maintaining contributions to O&M (slightly above average). Savings levels per household are comparable with, although not higher than, the sample average.

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<sup>19</sup> Again it should be noted that the oldest CDF financed schemes are still only seven years old, and therefore long-term sustainability has yet to be tested.

- There is encouraging evidence of operational sustainability: 30% of CDF schemes use local artisans for technical support, while 60% use woreda retail shops for sourcing spare parts
- Community management structures are being well sustained under CDF schemes, although all schemes perform well here (over 80% of WASHCOs active for schemes surveyed)

Other findings of interest include:

- The existence of a high variation in performance between woredas was confirmed, both in the case of RWSEP and for other modalities. This points to the importance of the capacity of the woreda administration as being a strong “exogenous” factor behind program performance.
- In most areas the scheme level indicators were equally strong for pre-CDF RWSEP schemes as for those funded via CDF (including in functionality rates, impressive given that pre-CDF RWSEP schemes are now mostly more than seven years old). This suggests there is some program-specific factor underlying the scheme development process.

The scheme survey also provided an opportunity to consult direct with users to discuss scheme performance and identify challenges. Generally, these discussions were positive and communities were satisfied with the service provided, although some challenges that were identified should be important to take into account as the CDF evolves (these are discussed further in Section 3.3 below):

1. Some communities observed that water quantity provided by the scheme during the driest months (February-May) was insufficient to meet their basic needs. See Box 2 for recommendations.
2. Although the CDF is undoubtedly serving some very poor people, it should be acknowledged that the mechanism design risks missing highly marginalized groups. This is due to the demand-driven nature of the support (which favors higher capacity and more accessible communities) and the capital investment limit (insufficient for communities with poor hydrology and therefore higher-technology requirements).
3. In some cases where community cohesiveness was less strong there are challenges in coordinating community management resulting in schemes being financed at times for quite small numbers of households, raising the unit cost per scheme.
4. The woreda water offices at times have difficulty in securing sufficient operational funds from the woreda budget in order to perform their supervision duties. This has implications for the potential to institutionalize the CDF mechanism.

These challenges are discussed further in Section 3.3 below.

### **1.3.2 Ingredients of Success**

The background analysis, scheme survey and stakeholder consultations have together revealed a number of ingredients that appear to underlie the relatively strong performance of RWSEP following the introduction of the CDF mechanism, as described above. Due to the intangible nature of some of these factors it is only possible to quantify their impact in a subjective manner. Therefore, it is perhaps more useful not to try and understand the CDF mechanism as a specific innovation, but as a package of features that have evolved under RWSEP over time, resulting in an approach that is highly suited and adapted to its current environment.

#### ***Factors Relating to the CDF Financing Mechanism***

The study isolates five core factors related to the funding mechanism that can explain the success of CDF:

- Simplified accounting of funds
- Simplified procurement of materials and services
- Use of community based project management
- Use of specific technical and governance controls/safeguards
- Development of technical and governance skills in the communities

Furthermore, the study concludes that the first three factors above are the main contributors to the relatively swift implementation rate which, compared to other implementation approaches in Ethiopia, is the most impressive achievement of the Community Development Fund approach. The purpose of this section is to assess these features in more detail as a basis for understanding how the CDF mechanism can help to inform the broader water and sanitation development effort in Ethiopia.

We will begin by looking together at the first three factors above: simplified accounting of funds, simplified procurement of materials and services, and use of community-based project management. A recurring theme in discussions with government staff was the relative ease of financial utilization under RWSEP. Tracing the experiences of the program over time suggests that the primary reason for this has been the shift under CDF to direct transfer of funds to communities, which has led to the removal of the major financial administration and procurement bottlenecks experienced in earlier phases of the program. By transferring funds directly to communities, the CDF has essentially outsourced the accounting of the funds to the micro finance institution and the communities. Simplified procurement has been achieved by allowing the communities to procure directly rather than using the more complicated and time consuming public sector and/or donor procurement procedures.

The transfer of funds to communities has had the further benefit of shift project management responsibilities to the communities. This has proved effective because the communities, unlike the woreda administration who manage such projects under traditional approaches, are focused on a single task, are highly incentivised to ensure completion of the works and, they are on site so can easily provide very close supervision. In effect, the CDF mechanism has allowed the government to tap into a large pool of available human resources (the community) and thereby increase the efficiency of project management. In turn, the government is then able to use its more limited staff time for overall supervision and program administration, rather than micro-management of financial and procurement processes.

An understandable and common concern with such community level management of funds is the risk that it will result in mismanagement of funds, either due to technical errors or due to misappropriation. The study has found that, in the vast majority of cases, such mismanagement has been avoided through the use of very effective technical and governance controls, put into place to ensure satisfactory technical standards, adequate cost control and discourage opportunist or fraudulent practices.<sup>20</sup> In summary, the specific controls/safeguards are:

- The communities account is opened and authorised by the Woreda Community Development Fund Board
- Disbursements are small (three or four instalments of less than Euro 600)
- Each withdrawal is authorised by the Woreda Water Resource Development Office
- Most payments are effected immediately after withdrawal from the bank
- Instalments require the community to show how funds have been used to date
- The unit price for most materials in the specific locality is known by Woreda officials
- The quantity to be procured is estimated by a technical person and is a standardised
- Items are procured by the water and sanitation committee; not by individuals

These in-built controls have ensured a high level of trust amongst all stakeholders involved in the program, which in turn has enabled RWSEP administrators to remain relatively flexible in the approach to financial management. For example, if there are problems with a specific woreda, this does not need to disrupt fund flows to other woredas, since funds are able to flow on the basis of woreda-level reporting rather than program-wide liquidation. Also, at a program level, un-receipted expenditures reports are sufficient to secure replenishments, and are only required after a one quarter lag (i.e. the first quarter report is required for the third quarter replenishment). In this sense, monitoring is allowed to be much more results-based than input-based (i.e. the

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<sup>20</sup> The scheme survey did reveal an isolated incidence of fund mismanagement in the case of Bibugn woreda, where WASH Committee members had been imprisoned for mismanagement of CDF funds.

program monitors physical outputs ahead of the specifics of how funds are utilized).<sup>21</sup> This is a significant contrast with the level of expenditure reporting required under other donor programs: the UNICEF WASH program, for example, requires close to 100 percent liquidation of receipted expenditures before subsequent disbursements can be made.<sup>22</sup>

This combination of simplifying accounting and procurement procedures together with the use of these specific controls is unique to the CDF mechanism, and arises from the direct transfer of funds to the communities and the communities using the funds responsibly and effectively. It should, however, also be noted that despite the simplification of these procedures under CDF there is still quite a high levels of technical assistance directed towards financial management in particular. This involves, for example, direct assistance to the woredas, both for expenditure reporting and for reconciling their reports with account statements from ACSI (which was noted by program staff as a particular challenge in terms of financial management). This intensity of technical assistance is discussed below.

Finally, throughout the study the impact of the CDF on community “ownership” and “empowerment” was identified by many stakeholders (federal government, regional government, donors, program staff) as having a crucial impact on program performance. Unfortunately, the intangible nature of these factors makes it difficult to verify with any certainty their impact on the overall performance of CDF. Nevertheless, one aspect that can be identified more concretely is the impact of the community management process on the building of technical and governance skills within the community. Transferring funds to the communities under CDF places a direct responsibility on them for planning and implementing their own water supply development. In this way, technical skills and collective decision making are tested and enhanced and the community as a whole better prepared for the future maintenance tasks. They become familiar with management of funds, already have a working bank account, and are in close contact with artisans that can help in more complicated maintenance tasks.

From the consultations conducted it is clear that the development of these skills, experiences and relationships has contributed towards the high levels of scheme functionality under CDF. Communities were well aware of all aspects of the development process and were clear about how to proceed when problems emerged. However, at present it is not possible to say whether this is *sufficient* to ensure sustainability since RWSEP is currently grant financing not only new scheme development but also major scheme maintenance, and therefore the ability of communities to independently maintain schemes over the long term has not yet been tested.

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<sup>21</sup> This is possible because the expenditure verification process is already taking place at the scheme level.

<sup>22</sup> Expenditure reporting under the World Bank – DFID Multi Donor Trust Fund has recently shifted in this direction, with replenishments now being possible on the basis of financial reports without accompanying receipts Statements of Expenditure (a requirement that previously created a major drag on disbursement rates). However, even by this comparison the reporting system under RWSEP is still very flexible.

Given the success in encouraging relatively high O&M savings rates, this will be an important area to test as the program looks to progressively withdraw.

### *Capacity Building and Technical Assistance*

In addition to the above factors which relate to the CDF mechanism, and specifically to the transfer of funds to communities, the study also identifies a further two crucial factors related to the background technical support provided by the program itself. These are:

- Pro-active capacity building of the private sector and where necessary substitution
- Pro-active capacity building of the public sector and where necessary substitution

In this regard, the study found strong evidence to support the widely held perception that, in addition to the role of the financing mechanism, the success of the CDF under RWSEP is also due to the strong support provided through the external “program”. In particular, there exists a clear willingness and capability under RWSEP for the program, through its staff and operational budget, to step in and provide services where the public and private sectors lack capacity.

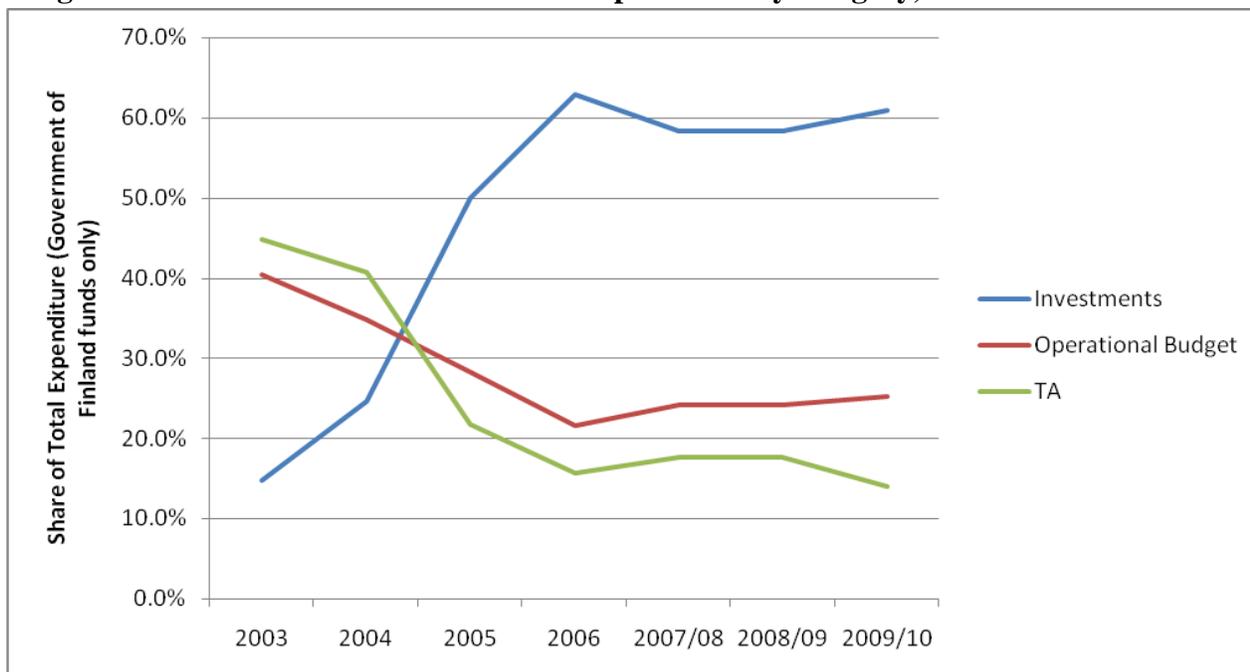
Currently, program support is being managed through a regional office which employs six professional staff: an international team leader, two regional-level advisors and three zonal advisors. The regional advisors provide backup support and capacity building for the regional bureaus, while the zonal advisors perform similar duties at the zonal and woreda level. RWSEP also finances the position of an accountant within the regional BOFED for the purpose of providing financial management support.

The involvement of this technical assistance in program implementation is significant. For example, the zonal advisors directly visit each woreda at least once every two weeks to support them in all aspects of program management as required. The accountant at BOFED also travels to the woreda level around 3-4 times a month to support woredas in their financial management activities. Although this support undoubtedly leads to better results for the program, it has also created obvious risks in terms of institutional sustainability. Indeed, one regional stakeholder noted that without the existence of the program office, effective implementation of CDF through the existing public sector would currently be unthinkable.

In this context it is useful to look in more detail at the level of assistance provided under RWSEP. Figure 3 shows how operational and technical assistance spending has come down as a percentage of total budgets. In fact, the figures show that even at the start of Phase III in 2003 these two categories made up the large majority of expenditure, before the sharp rise in physical investments reduced the shares to their current levels of around 14 percent (technical assistance) and 25 percent (operational budget). This in turn means that the level of assistance per new

scheme has come down dramatically, although the extent to which this can continue is questionable, given that the relative shares appear to have levelled off.

**Figure 3: Breakdown of annual RWSEP expenditure by category, 2003 – 2009/10<sup>23</sup>**



Comparing this breakdown against other donor programs is complicated by differences in the categorization of expenditures. Nevertheless, a detailed look at the budget for 2008/09 under the World Bank–DFID WASH program shows the investment budget as making up close to 80 percent of a total budget of around US\$ 40 million, with the remainder being used for a mixture of program support and capacity building. This may be somewhat of an over estimate, since some items captured under operational budgets for RWSEP may be captured under investments for the WASH program. Nevertheless, this does lend additional support to the general perception that the share of budget being used to backstop investments under RWSEP is still quite high relative to other programs. The challenges this creates in terms of CDF ‘institutionalization’ are discussed further in section 3.3 below.

Although involvement is less intensive on the private sector side, here the program has also been very actively involved both in capacity building and substitution. This has included support for the development of a pool of local skilled labour through long-term training and other support services for local artisans, such as provision of construction tools and access to credit. At times RWSEP has also provided a substitute for the lack of functional supply chains, such as via

<sup>23</sup> Note that 2003-2006 data relates to expenditure, while 2007/08 onwards is budget data. Since budgets have closely correlated with expenditures under Phase IV it can be assumed that these figures closely correspond to actual expenditures. The graph is also adapted for the shift from calendar year to financial year budgeting after 2006.

transport of materials and stockpiling and distribution of spare parts on behalf of woredas for sale to communities. Efforts are currently underway to encourage a longer-term solution via support for private sector supply of spare parts through local shops.

### ***Other Locally Conducive Factors***

This study has also confirmed that the performance under RWSEP has benefited from a number of regionally conducive factors relating to the enabling environment in Amhara and to the history of the program. These include:

- ***The presence of ACSI, a renowned and locally based credit institution***

It is important to recognize that transferring funds directly to communities in Ethiopia is not necessarily a straightforward process. In Amhara, this has undoubtedly been aided by the existence of ACSI, which provides a highly convenient and efficient institutional mechanism through which to channel resources to communities. With 185 sub-branches in Amhara, each with around 10-12 staff, ACSI provides an invaluable mix of financial management capacity combined with geographic reach. Furthermore, its quasi-government status and its low administrative charges imply that ACSI is genuinely operating as a social finance organization (not primarily for the purpose of profit), and as such is trusted both by government and by communities. Therefore, while it is possible to imagine alternative arrangements for the CDF in Amhara, it is hard to conceive of one that would work anywhere near as well.

The early experiences in Benishangul-Gumuz appear to reinforce this point. Unlike ACSI, the Benishangul Gumuz Micro Finance Share Corporation (selected to play the same role) does not have the same geographic reach in terms of sub-branches, which is creating challenges for transmission of WASHCo funds. The arrangement in Benishangul is also more costly, with a 7 percent commission being charged in comparison to only 3 percent for ACSI. It is too early to say what implications this will have, but it does lend weight to the perception that there is a certain ACSI-specific element behind the ability of CDF to implement the community transfer process so effectively in Amhara.

- ***Continuity and length of program support***

Secondly, it is important to acknowledge the length of time that RWSEP has been under implementation in Amhara. Remaining engaged continually in one region for over 15 years has inevitably provided a very strong foundation upon which to build each subsequent phase of the program. This has allowed the program to internalize lessons learnt and to build upon a solid base of capacity and relationships that take time to nurture. In fact, it was arguably this learning process that led to the development of the CDF, a mechanism highly suited and adapted to the conditions for water and sanitation financing in Amhara. The impact of this progression is evident from the output figures discussed earlier. This is not to say that all efforts to replicate

CDF would require a similar time period, since much of the learning has already been done. Nevertheless, like for most new projects, for the CDF to be introduced elsewhere it would be probable that a reasonably long period of capacity building and familiarization would be required before effective results could be expected.

- ***Favourable geography that allows the use of simple technology***

Thirdly, as a community-managed approach, the CDF mechanism is particularly well adapted to implementation via low cost technologies. Hand dug wells and spring developments can be implemented by local artisans without lengthy contractual agreements, and therefore tend to be more straightforward irrespective of the funding mechanism. In Amhara, RWSEP has been in the fortunate position of being able to continually extend its reach without moving up the ‘technology ladder’, since in the current CDF woredas the prevailing hydrology lends and population densities lend themselves well to simple community-based schemes. For these reasons, it has not been necessary yet to examine in detail the potential for development of more complex schemes through CDF. Whether or not this is a constraint is open to questions, since the need for such low cost schemes is likely to continue to exceed available resources for some to come, and therefore it may be better for CDF to simply continue with its current low-cost niche focus, to which community-management is naturally suited.

### **1.3.3 Potential Challenges**

#### ***Institutionalization and Program Exit***

As for any program with substantial external support, arguably the major challenge for RWSEP is how to find a way to genuinely ‘institutionalize’ the CDF mechanism such that it would be possible for the government to manage the process independently, without the direct support of a program office or similar technical assistance arrangement. At present, it does not seem that this would be a realistic possibility; a challenge that was readily acknowledged both by RWSEP staff and Government of Finland officials.<sup>24</sup> Institutionalization at the level of the regional government appears to be a particular challenge.

Nevertheless, progress has been made in this direction. The discussion above highlighted the substantial reduction in the proportional share of technical assistance and operation budgets over the third and fourth phases of RWSEP, albeit still at relatively high levels. Also, the

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<sup>24</sup> The issue of government’s own commitment to capacity building was discussed with a number of donors, who generally agreed this was a ‘grey area’. Although external support is gratefully received, there is little evidence that the government would internalize anything close to the kinds of technical assistance costs currently being met by external programs. This is a challenge throughout the system: RWSEP staff noted that communities have often proved unwilling to contribute towards training and travel expenses out of their own funds.

‘institutionalizing’ of CDF has been made a priority during phase four of RWSEP, as stated in the 2009/10 technical assistance work plan:

“Phase IV of RWSEP constitutes the phasing out of the Government of Finland’s support to the Region through RWSEP and is characterized by a full ownership of the Program by the Regional Government, whereby the Governmental establishment at its various levels assumes the responsibility for the Program’s continuation.”

As part of this strategy, the program is attempting to increase the intensity of capacity building at zone and woreda level, while also withdrawing where possible from direct interventions. For example, training has shifted to a zone-level “Training of Trainers” approach, as opposed to program staff providing training directly to woreda staff. Also, under Phase IV a plan has been developed to progressively streamline the program office in order to reduce government reliance on program support. So far, elements of this plan have been implemented, including the termination of two Regional Advisor contracts at the end of 2008/09, although this is still behind the original schedule, which was to phase out all four regional advisors by this date. Upcoming deadlines under this plan also look unlikely to be met, including the withdrawal of the long term team leader and three zone level advisers by the end of June 2010, and the phasing out of replenishment of CDF funds to ACSI from RWSEP budget by the end of June 2010. In fact, the 2009/10 technical assistance work plan appears to step back from the idea of program “exit” altogether, as implied in reference to an upcoming “CDF Generation II”:

“The activities of the Transfer Stage will be interlinked with the development of the CDF Generation II and it seems likely that some CDF-specific organization arrangement would be put in place for an ensured continuation of WASH development through CDF approach.”

### ***Reaching Highly Marginalized Communities***

The large majority of communities in rural Amhara survive on subsistence agriculture, and in targeting these groups the CDF mechanism is certainly serving low income groups. Nevertheless, there is an inevitable trade-off resulting from the demand-driven nature of the program, in that applications are more likely to come from more accessible communities (where promotional work is easier) and from those with more capacity to manage the process, who are also likely to be better off.

This is not a failing of the mechanism; it is simply the flip side of a demand-driven selection process. It could however, be partially addressed through different approaches, such as introducing a varying subsidy level according to the ability of communities to pay. RWSEP has also been adaptable to this issue by at times financing schemes for relatively small numbers of households in the more marginalized communities. This has negative implications for unit cost, but this is inevitable if such communities are to be reached.

Within communities, this equity issue does not seem to have caused problems. In fact, in many cases there is evidence that communities have organized their own methods for cross-subsidization of poor households. This again highlights the benefits of community cohesiveness for the successful application of the CDF approach.

### ***Environmental Management***

The use of low cost hand dug wells can be a highly cost-effective means of rapidly increasing water supply access in rural areas. However, the shallow depth limits of such technologies can result in limited volumes in countries, such as Ethiopia, where rainfall has a high temporal distribution. Observations

during the scheme survey and feedback during the CDF Summit both pointed to the challenge of maintaining sufficient water supply throughout the year. Despite the relatively low volumes required to meet needs, some communities observed that during the driest months (February-May) water rationing was being implemented. The risks of greater climate variability and increasing extraction rates due to economic development mean that this issue is only going to become more significant over time. See Box 2 for recommendations.

#### **Box 2: Recommendations for Strengthening Environmental Protection under CDF**

In cases where the use of shallow hand-dug wells are insufficient to meet supply needs during the driest months a number of approaches could be considered for incorporation into the CDF:

- Strengthen coordination with woreda agricultural desk to improve natural resource/watershed management within the catchment
- Experiment with deeper dug well technologies and multiple spring catchments (may require increasing maximum capital threshold)
- Use multiple hand dug wells to decrease pressure on individual sources and lower the cost of such by using rope pumps
- Greater emphasis on siting to ensure schemes are situated in areas of maximum local yield

### ***Delegated Procurement Management***

Although not assessed in detail, there appear to have been cases under CDF where procurement management has been delegated to the woreda level, in cases where there was insufficient capacity to manage the full process at community level. This appears to be especially true in the more remote woredas of Benishangul Gumuz.

Although in some cases this may be a logical adaptation, care should be taken that procurement procedures are not bypassed in this process. Woredas can and should play an advisory role in procurements undertaken by the community, but where full responsibility is delegated to the

woreda level then the program should ensure that officials revert to government procurement procedures under management of the woreda finance office. It appears that this has not been a major issue until now, but may become more prominent if higher technology options are further tested (and which will likely require a greater level of intervention on the part of the woredas).

### **1.3.4 Recommendations for Strengthening the CDF Mechanism**

While the evaluation has found that the CDF mechanism is performing well, the study points to a number of recommendations that can be made in order to further strengthen the approach:

1. Return to promoting the use of the CDF mechanism for institutional sanitation, and ensure an even closer coordination between the water supply investments and household sanitation and hygiene promotion efforts;
2. Increase coordination between CDF interventions and the environmental and catchment protection activities of the agricultural sector to preserve and enhance water resources;
3. Complete the WASH inventory in all woredas supported so far by the CDF, using the formats and processes developed under the WASH monitoring and evaluation system;
4. Continue to adapt the CDF mechanisms to different circumstances e.g. use of the mechanism for more complicated technologies; methods for delegation of procurement to woreda for remote locations, etc;
5. Introduce the strategic woreda WASH plan concept in all CDF woredas, both to encourage woreda-wide planning and as a basis for integration of CDF into a programmatic approach;
6. Through cooperation with other partners, ensure alternative mechanisms are available at regional and woreda level for communities which are not suitable for use of the CDF mechanism (e.g. do not have adequate water resources for simple technologies or are not capable of managing a CDF intervention);
7. Update the CDF manual for inclusion in a later WASH program implementation manual;
8. Encourage the local procurement of hand pumps in order to further strengthen the spare part supply chain;
9. Introduce formal annual auditing under the woreda finance office to further strengthen internal controls;
10. Consider options for introducing rope pumps instead of hand pumps where cost effective in order to increase sustainability;
11. Withdraw direct program assistance on a step by step basis from those Woredas that have been supported longest and are the most prepared as a means of testing the longer term institutionalization of the approach;
12. Support the strengthening of the Regional WASH Coordination Office in order to facilitate a progressive transfer of program management responsibilities into the national WASH structure.

## **PART 2: MAINSTREAMING THE CDF MECHANISM**

The study has so far supported the conclusion that the CDF mechanism is performing well, and has attempted to identify the key ingredients of success underlying the approach. We therefore now move to the final section of the study, and the last of the questions identified at the outset: what is the scope and recommendation approach for mainstreaming the CDF mechanism, or its key features, across the sector as a whole?

### **2.1 Mainstreaming Scenarios**

Before looking at what direction any future mainstreaming of the CDF mechanism may take, it is first important to understand the likely future direction of water and sanitation sector financing in Ethiopia as a whole. At present, this situation is relatively dynamic, and it is possible to envisage a number of different scenarios for the sector, each with different implications for the mainstreaming of the CDF mechanism. In the view of the authors, the most likely scenarios can be categorized as follows:

#### **Scenario 1: Status Quo**

Until now, the water and sanitation sector has been funded primarily through a mix of disparate projects, each with a different financial backer and each with different implementation modalities. Put together, these projects have generated significant financing for the sector and have resulted in much progress, although at the cost of fragmenting the sector into a highly projectized mindset and institutional structure. These projects also generally conform to donor systems for procurement and financial management, rather than aligning behind government systems.

Over the past few years, small steps have been taken towards harmonization, primarily around the national WASH program, led (on the donor side) by the World Bank. However, in the short-term (i.e. the next two years) this projectized financing scenario will inevitably continue, albeit perhaps with minor additional harmonization steps, such as the pooling of ADB finance directly under the Multi-Donor Trust Fund. In the medium term, there now appears to be both enthusiasm and momentum for a major shift towards a pooled financing or sector budget support approach, although given the amount of work needed to make this happen there is still a moderate likelihood that projects will continue to dominate into the medium term. This would be the most challenging scenario in terms of CDF mainstreaming, since any major scale up would essentially require an additional stand alone project, as has been the case in the shift to Benishangul-Gumuz.

## **Scenario 2: One National WASH Program**

Given the costs imposed by the current system, there has recently been an effort to catalyze a shift to a truly harmonized sector program. This was highlighted as a priority undertaking during the recent Multi-Stakeholder Forum (October 2009), although little substantive progress has yet been made to begin the ‘transition plan’ agreed to during this event.

Under this scenario, it is possible to envisage a substantial pooling of funds from most of the major donors under a harmonized single WASH program. This would most likely be modelled around the current national WASH program approach, albeit with significant potential for greater use of government procurement and financial management systems. A particular catalyst for this could be the upcoming expiration of the current World Bank funding in 2011: if new funding is considered by the Bank this may provide an opportunity to bring a significant financial envelope into the harmonization dialogue (an incentive that has been missing recently).

Under this scenario, it is possible to envisage the CDF mechanism becoming one of a number of options available for implementation via the basket, or pooled, fund. For example, a region such as Amhara might choose to channel, say, one third of its pooled fund allocation through CDF, with the rest remaining under the more conventional government-managed approach. Under such an approach it would be logical to also pool funds for capacity building (a common good for all). This scenario would likely require substantial ‘enabling environment’ work in those regions not currently using the CDF, and therefore may require the focus of the Government of Finland to shift away from region-specific support to supporting such an enabling environment for CDF more generally.

## **Scenario 3: Sector Budget Support**

Possibly the most effective scenario would be a shift to some kind of a sector budget support arrangement, either for the water and sanitation sector specifically or, more likely, as part of a broader pool of budget support for basic services as a whole. This is essentially what is currently being piloted via the Local Investment Grant, discussed above, and a substantial scale up of this approach is a relatively strong possibility in the medium term. Under such a scenario, capital investment finance for all basic services, including water and sanitation, would be channelled directly to regions and woredas as part of the Block Grant. This mechanism would greatly enhance both harmonization and alignment, although for water and sanitation there would certainly be the need for the continuation of a strong capacity building component in order to ensure funds are used effectively and also to ensure the sector gets its fair share.

The implications for the CDF are similar to under Scenario 2 above, although there may be additional procedural issues, such as the ability of regions to divert Block Grant funding through local financial intermediaries. This is discussed in more detail in section 4.2 below, but first we

shall look at the opportunities for mainstreaming the CDF mechanism in the context of these alternative scenarios.

The transition between these scenarios will be a challenge but could help to create the enabling conditions for a shift towards the optimal final outcomes, namely a form of sector budget support:



Under each of these scenarios, it is important to keep in mind that the CDF mechanism can only be used where:

- Geographic conditions allow simple technology (unless subsequent experience shows that communities can handle more complex technologies)
- Financial intermediaries are present at a density which implies that they have other tasks as well
- Communities are cohesive

In turn this means that the CDF mechanism:

- Can never be the only mechanism but will have to fit into a scenario where several mechanisms are possible
- Particularly for the sector budget support scenario, and for all scenarios in the long term, is dependent on whether government procedures are flexible enough to allow transfer of funds to communities via a financial intermediary

## 2.2 Rationale for Mainstreaming

The Universal Access Plan review, recent WASH Joint Technical Reviews and the current CDF evaluation study, all point to a number of lessons learnt from use of the CDF mechanism that could assist Ethiopia in pursuing the Universal Access Plan and implementing policies on use of low cost technology and mass mobilization. There is strong evidence that the potential benefits of mainstreaming the CDF approach, where conditions are suitable, include:

- A rapid implementation rate, due to simple procedures and community management
- Effective control of unit costs due to tight local controls
- High degree of functionality associated with higher community responsibility and skills

The features of the CDF mechanism that are contributing to these benefits with potential to be mainstreamed are:

- Transfer of funds to the community using financial intermediaries where appropriate
- Use of specific controls that allow adoption of simplified procurement and financial management procedures
- Use of community structures for project management
- Pro-active approach to capacity building of the private and public sectors

### **2.3 Potential Approaches to Mainstreaming**

Mainstreaming can take place in two ways:

#### **1) CDF as a modality for rural water supply within the national WASH sector**

The CDF modality can be introduced as one of an array of financing (and implementing) modalities in the national WASH approach so that where conditions are suitable, investment funds can be transferred to communities via financial intermediaries. The CDF mechanism is particularly suitable as a mechanism under the WASH program where:

- Technology is simple enough to allow community management of implementation
- There are financial intermediaries with branches in close proximity to the communities
- Communities are cohesive

#### **2) Adopting features of the CDF in other modalities**

Lessons learnt from the CDF approach can inspire existing approaches to introduce simpler procedures, to transfer more responsibility to communities and to adopt a proactive approach in bridging gaps in private and public sector delivery systems. This would imply greater attention given to:

- Simplifying accounting and procurement
- Increasing direct community involvement in project management
- Introducing more flexible safeguards to compensate for simpler accounting and procurement
- Combining gap filling with capacity building of the private and public sectors where needed

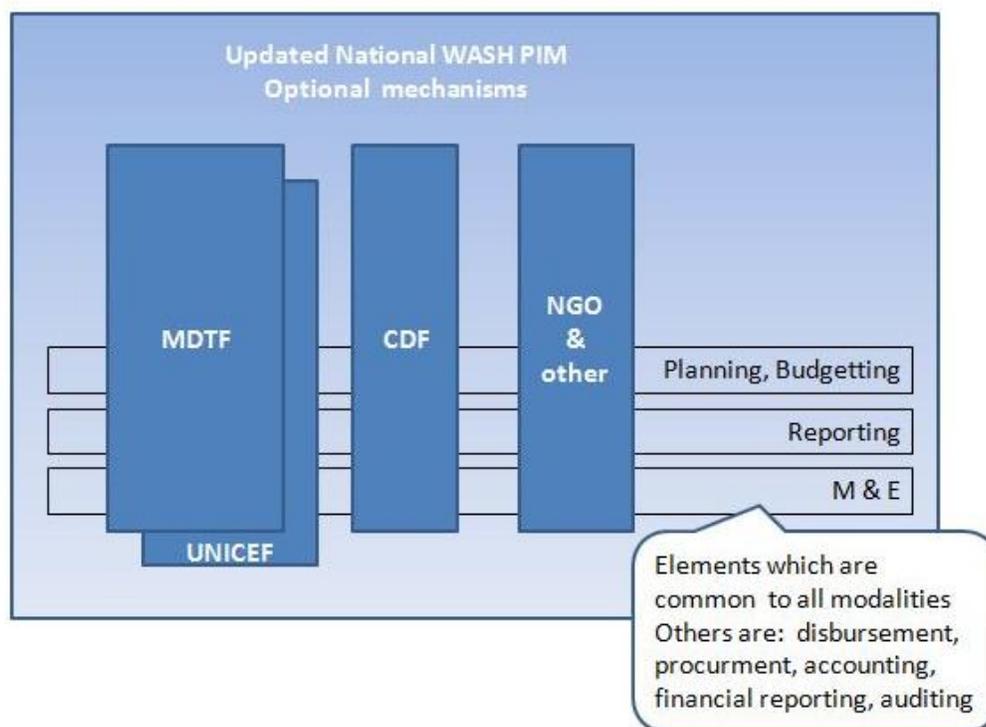
## 2.4 Mainstreaming Strategy

The mainstreaming strategy for CDF is linked to the overall effort of aligning all current modalities to the evolving Ethiopian national sector framework. The ultimate aim would be a national system that allows Woredas and regions to make use of:

- A community transfer finance and implementation mechanism for simple technologies and where other circumstances are suitable
- A government block grant finance and implementation mechanism for more complex technologies and in situations where this mechanism is preferable
- NGO and other support finance and implementation mechanisms

The community transfer mechanism would be based on the CDF. The block grant system would be improved through the innovations tested and introduced by UNICEF and the Multi Donor Trust Fund. NGO and other support will in most cases not involve cash transfers to government but will pay directly for construction works (i.e. in kind). In all cases the mechanisms are a combination of finance and implementation procedures.

Making use of these three mechanisms will allow woredas and regions to respond flexibly using tested strategies as illustrated below:



In the interim, before sector budget support becomes a reality, a “shadow alignment” can take place whereby donors channel their funds to woredas and regions via their preferred mechanisms under the guiding umbrella of a WASH Program Implementation Manual.<sup>25</sup> Woredas and regions, by developing Woreda strategic WASH plans, will have a single plan, a single budget, a single report and a single monitoring and evaluation system. By saving resources and increasing coherence, a higher quality of planning, budgeting and reporting will result. For each scheme, woredas and regions will, depending on the circumstances, use either the CDF mechanism (for simple technologies) or fully government managed mechanisms (where demanded by more complex modalities). They will thus, in principle, because of the geographic variation in their areas, be capable of using either.

Once the RWSEP and Fin-WASH (Benishangul) programs come to an end, funds for the CDF mechanism will no longer be donor specific. Instead, donors (including Finland) would be free to earmark funds for use by the community transfer mechanism or, as and when it is deemed suitable, simply provide sector budget support allowing regions and woredas to freely select between mechanisms depending on the circumstances and unconstrained by any limits imposed through earmarking.

The World Bank, African Development Bank and UNICEF projects effectively support the government managed mechanism using safeguards (mainly in procurement and financial management) and other adjustments / improvements to the national systems. To avoid confusion and overlap, woredas would probably not make use of more than a single donor when using a government managed mechanism. Where possible, the safeguards and adjustments should be harmonised, as there is little logic or benefit in having different procedures for the same task.

Intensive capacity building of Woredas, regions, communities and the private sector is a temporary task and in principle does need to be integrated into core government functions. In the long term there is a routine human resources development function that needs to be strengthened. There would be a benefit in coordinating intensive “one off” capacity building. This can be done at regional level under the umbrella of the regional WASH coordination structures. Capacity building, instead of being directed through project vehicles, could be assembled under the regional WASH coordination team using CDF and Woreda support group type approaches as well as providing more general water sector capacity building relevant for all modalities.

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<sup>25</sup> As a follow up to this report, the consultant team can support the process of developing the terms of reference for the development of a harmonized WASH Program Implementation Manual, on the basis of the transition plan developed for the 2009 Multi-Stakeholder Forum.

## 2.5 Mainstreaming Recommendations

3) The CDF should be mainstreamed into the national water sector framework so that it becomes a core modality available for all regions and woredas where it is appropriate. In support of this, the following actions should be taken:

- National authorities lead by the Ministry of Water Resource (MOWR) and including the National WASH Coordination Office and the Ministry of Finance and Economic Development should integrate the CDF mechanism into the national strategy for the rural water supply sector;
- Subsidy levels for rural water supply should be evaluated and agreed in line with the water policy, in order to harmonise to the extent possible the CDF approach with the national UAP strategy;
- Update the current draft WASH Program Implementation Manual in line with the Multi-Stakeholder Forum undertaking. The manual should be simplified where possible and should allow for: multiple modalities; improved coordination of capacity building efforts between modalities and; development of a single woreda strategic WASH plan, budget and report that can serve all modalities;
- Map the potential for adopting the CDF in other regions of Ethiopia (presence of favourable technologies and financial intermediaries, and using the present self supply mapping as a basis);
- Withdraw intensive program based support, step by step, from well functioning woredas and transfer program support, step by step, to new CDF woredas in order to test if the CDF approach can be sustained once direct program support withdraws.

4) A mainstreaming plan with the following immediate and short to medium actions should be implemented:

- Immediate actions:

Action 1) In Amhara and Benishangul Gumuz: the regional government to discuss with UNICEF and MDTF donors the scaling up of CDF mechanisms and, if positive, then;

Action 2) Expand the mechanism to new woredas and make the necessary support arrangements, such as use of zonal advisers, extension of agreements with financial intermediaries, training and other back up.

- Short to medium term actions

Action 3) Ministry of Water Resources shall facilitate the introduction of CDF mechanism to other regions to create the awareness of an effective community implemented financing modality.

Action 4) In other regions: the regional governments to make a policy decision on use of the CDF mechanism and discuss with UNICEF and MDTF donors on use of CDF mechanisms;

Action 5) If the policy decision and discussions are positive then set up the necessary support structures and agreements with financial intermediaries – making use of assistance from Amhara and Benishangul-Gumuz where needed;

Action 6) Regional governments that are interested to adopt the CDF mechanism as an option under the national WASH strategy to confirm procedures to be used for treasury funds, including whether the existing subsidy level (85%) should be used for treasury funds.

### Annex 1: Summary of key data from scheme survey

Table 1: Visited schemes by financing modality

RWSEP (Pre CDF)	RWSEP (CDF)	National WASH Program	UNICEF	Government Block Grant	Others	Total
13	16	12	15	11	8	<b>75</b>

Table 2: Visited Woredas and Kebeles

Woredas	No. of Kebeles
Bahir Dar Zuria	6
Bebugn	11
Deber Elias	4
Dejen	5
Dembecha	8
Gonji Kolala	2
Machakel	5
Yilmana Densa	2
<b>Total</b>	<b>43</b>

Table 3: Visited schemes by technology type

	Hand Dug Well	Protected spring on spot	Shallow Borehole	Spring with rural pipe scheme	Total
RWSEP (Pre CDF)	9			2	11
RWSEP (CDF)	13	1		4	18
Government Block Grant	9	1	1		11
National WASH Program	6		5	1	12
UNICEF			14		14
Others	6	1		1	8
<b>Total</b>	<b>43</b>	<b>3</b>	<b>20</b>	<b>8</b>	<b>74</b>

**Table 4 Year of construction of schemes**

	RWSEP	Government Block Grant	National WASH Program	UNICEF	Others	Total
≥2008	7	2	5	3		<b>17</b>
2005-2008	11		6	10	5	<b>32</b>
<2005	11	9	1	2	3	<b>26</b>

**Table 5: Assessment of build quality**

	Very poor	Poor	Satisfactory	Good	Excellent	Total
RWSEP (Pre CDF)		1	4	5		10
RWSEP (CDF)		2	6	7	1	16
Government Block Grant		3	1	6	1	11
National WASH Program		3	4	4		11
UNICEF		1	6	6	1	14
Others		0	1	4	1	6
<b>Total</b>	<b>0</b>	<b>10</b>	<b>22</b>	<b>32</b>	<b>4</b>	<b>68</b>

**Table 6: Perceptions of quality of service**

	Very poor	Poor	Satisfactory	Good	Excellent	Total
RWSEP (Pre CDF)		2	2	6	1	11
RWSEP (CDF)	2	2	2	8	2	16
Government Block Grant		4	5	1	1	11
National WASH Program		3	9			12
UNICEF		3	8	3	1	15
Others	1	1	2	3		7
<b>Total</b>	<b>3</b>	<b>14</b>	<b>29</b>	<b>21</b>	<b>5</b>	<b>72</b>

**Table 7: Scheme functionality Status**

	Functional	Functioning but faulty	Not functional	Abandoned	Total
RWSEP (Pre CDF)	13				13
RWSEP (CDF)	15	1			16
Government Block Grant	10		1		11
National WASH Program	9	2			11
UNICEF	14		1		15
Others	7		1		8
Total	68	3	3	0	74

**Table 8: Is the WASHCO holding meetings?**

	Yes	No	Of yes:	Meeting Regularly	Not regularly	Very rarely
RWSEP (Pre CDF)	12	1		5	2	5
RWSEP (CDF)	16			10	3	3
Government Block Grant	9			7	0	2
National WASH Program	14			8	2	4
UNICEF	14			11	2	1
Others	5	2		3	1	3
Total	70	3		44	10	18

**Table 9: Use of retail shops in kebeles and woredas for spare parts**

RWSEP (Pre CDF)	RWSEP (CDF)	National WASH Program	UNICEF	Government Block Grant	Others	Total
4 of 13	9 of 16	2 of 12	1 of 15	1 of 11	2 of 8	<b>19 of 75</b>

**Table 10: Use of local artisans for follow up technical support**

RWSEP (Pre CDF)	RWSEP (CDF)	National WASH Program	UNICEF	Government Block Grant	Others	Total
0	5 of 16	0	0	0	0	<b>5 of 75</b>

**Annex 2: List of Stakeholders Consulted**

<b>Name</b>	<b>Position</b>	<b>Organization</b>
Tilahun Tadesse	Head, Bilateral Cooperation Sub Process	MOFED
Aynalem Mamo	Head, Nordick Desk	MOFED
Gelebo Sengogo	National WASH Coordinator	MoWR
Antti Inkinen	Water Advisor	Finland Embassy
Martha Solomon	Water Advisor	Finland Embassy
Yitbarek Tessema	WASH Program TTL	World Bank
Paul Deverill	WASH Chief	UNICEF
Radio Save	Senior Water and Energy Advisor	Italian Cooperation
Belete Muluneh	Senior Water and Sanitation Specialist	WSP-Ethiopia
Elis Karsten	Team Leader	RWSEP Program Office
Yohannes Melaku	Water Advisor	RWSEP Program Office
Melaku Worku	Zonal Advisor	RWSEP Program Office
Mulatu Ferede	Program Director	RWSEP Program Office/RWB
Anmut Admassu	CDF Accountant	RWSEP Program Office
Muluneh Genetu	CDF Financial Advisor	RWSEP Program Office
Mamaru Tsedeku	Head, Regional Water Resource Bureau	Regional Water Resource Bureau
Asamnew Negash	Accountant/WASH Program	Regional Water Resource Bureau
Getinet Asamenewu	UNICEF program Coordinator	Regional Water Resource Bureau
Tesfaye Yismawu	Head, Zone Office	West Gojam Water Resource Office
Desalegn Ayalew	Director of Finance	ACSI

Telahun Eshete	Deputy Bureau Head for Public Finance	BOFED
Melaku Beze	Program Coordinator	Yilmana Densa Woreda
Yibeltal Getinet	Head, water Resource Office	Gonji Kolala Woreda
Zemed Sewunet	Program Coordinator	Gonji Kolala Woreda
Molla Eniyewu	CDF Supervisor	Gonji Kolala Woreda
Beyene Ashenafi	Head, water Resource Office	Bahirdar Zuria Woreda
Linger Barkilgn	Program Coordinator	Bahirdar Zuria Woreda
Yenenesh Adiss	Water Supply Engineer	Bahirdar Zuria Woreda
Tebebu Kumulachewu	Head	Bahirdar Zuria ACSI Sub Branch
Addisu	Head of Water Department of East Gojam Zone	Water Department of East Gojam Zone
Ambelu Meselu	Head of Bibugn Woreda Water office	Bibugn Woreda Water office
Mamaru Alebachew	A/head of Machakel woreda water office	Machakel woreda water office