1. Key development issues and rationale for Bank involvement

The vision of the GRZ in the water sector, as expressed in the 2001 Poverty Reduction Strategy Paper (PRSP), is to ensure that sector resources are effectively developed to contribute to poverty reduction. Zambia has demonstrated a long standing commitment to the reform process, which started in 1994, with the adoption of a forward looking National Water Policy. This led to the development of sub-sector strategies, aligned with the CAS currently under preparation, that are aimed at making a difference in people’s lives. These include improving human capacity through better hygiene behaviors and access to clean water and sanitation, maintaining an improved quality of life from access to sustainable water supply and sanitation (WSS) services, and addressing vulnerable groups where access to water for both potable and agriculture use (food security) is lacking. The sub-sector strategies that address these goals include: the Institutional Framework for the Water and Sanitation Sector, Peri-urban Water and Sanitation Strategy (targeting urban low income communities), Community Water Supply and Sanitation Strategy (targeting rural areas), and the Environmental Sanitation Strategy. The ongoing work of the Water Resources Action Plan (WRAP), which in part addresses water shocks such as drought and flood, has wide GRZ support. The Water Supply and Sanitation Act (1997) provided for the efficient and sustainable supply of WSS services under the regulation of the National Water and Sanitation Council (NWASCO) and the establishment of commercially viable water utilities (CUs). To-date, nine CUs have been established paving the way for the commercialization and greater private sector participation (PSP) in the urban water sub sector.
Despite this sound policy environment, the sector is facing an uphill struggle with significant implementation difficulties. At the top of the list is the overarching vulnerability of the economy to ‘water shocks’ – floods and droughts - resulting from climate variability and resource management failures. There is evidence of increasing competition for water resources and increasing deterioration of the resource base. For basic services urban coverage appears high at 88% -- but about 40% of these consumers, mainly the poor, are served by peri-urban systems that are neither reliable nor safe. Further, urban systems are failing and are not sustainable without major government financial transfers. Rural coverage is now about 60% and also relies heavily on central government support. Overall the average coverage is 76% and the sector will need to achieve a sustainable coverage of 88% by 2015 to meet the Millennium Development Goal (MDG). Sewer and sanitation coverage is inadequate and cholera is endemic in Lusaka and Ndola. A significant number of preventable diseases in Zambia are related to poor environmental sanitation. To achieve progress, meet the MDGs, and improve the quality of life for about 3.5 million urban Zambians, the following key development issues need to be addressed:

- **Link between sustainability and poverty:** Viable CUs are the only efficient vehicle for provision of sustainable WSS services in urban areas, given the required quantity, quality, reliability and unmet demand. Achieving CU sustainability is a precondition for significant improvement and expansion in service delivery to the urban poor.

- **Policy implementation and governance failures undermine sustainability:** While CUs are necessary to the provision of WSS services to the urban poor, their ongoing operation and maintenance remains a major problem and cost recovery rates are only about 50%. The CUs are kept operational through a series of direct and indirect subsidies which are estimated at about $10 million per year nationwide. These subsides perversely support consumers on inefficient piped systems at the expense of the unserved, mainly the poorest living in peri-urban areas. The situation is exacerbated by the non-payment of water bills by GRZ institutions. Further, the innovative and sound sector regulatory practices have been severely undermined by the failure of the GRZ to take prompt action to reappoint the sector’s regulatory Board.

- **Sanitation:** Sanitation has not come to the forefront of the policy dialogue. While recognized as an important issue with respect to health and quality of life impact, it remains a problem addressed ineffectually in a fragmented way. Sewerage and sanitation coverage rates are unacceptably low and it is unlikely that Zambia will meet the MDG for sanitation by 2020.

- **Water Resources:** Specific sectors and the economy as a whole are susceptible to ‘water shocks’ resulting from climate variability and resource management failures. Such shocks particularly effect very poor in terms of direct disaster impacts, food security and the reinforcement of long term risk-aversion survival strategies.

The incidence of urban poverty is on the rise in Zambia. The proposed project will concentrate on increasing access and improving reliability to safe water and sanitation services to urban poor in the Copperbelt and Lusaka provinces; these provinces together represent about 75% of the total urban population. The project will: (i) promote equity in service provision, increase financial self sufficiency of the WWS sector and therefore decrease GRZ subsidies to the sector; and (ii) support economic growth, including the Copperbelt diversification strategy, by assuring the WSS service provision achieves economies and efficiencies to deliver services to current and future consumers (domestic and industrial) in a reliable and cost effective manner. To maintain
this momentum and to ensure sustainability, the sector reform program needs to be upgraded and revitalized. Policy making capacity has broken down and needs to be revitalized to carry forward and update the 1994 sector reform program.

IDA is capitalizing on its knowledge and experience of the urban WSS sector in Zambia as a result of the ongoing Mine Township Services Project (MTSP) and recently closed Urban Restructuring and Water Supply Project (URWSP), and through the WRAP which IDA manages. Given the strong emphasis on private sector approach, lessons show that adequate financial and technical resources during project preparation, consensus building, strong government commitment, and a secure regulating framework are required for success. The main lessons learned from the Bank-assisted projects and partner activities in Zambia and other countries in the Africa region include:

- Across the sector, a critical lesson learned is that a good water and sanitation policy must strive for cost recovery and sustainability; proper pricing and a good tariff policy are most important in demand management.
- The most efficient way to serve peri-urban consumers is through a strong utility as there are no other comprehensive mechanisms that can provide the service; peri-urban schemes must become as efficient and financially viable as possible. Commercial utilities need to have capacity to manage peri-urban areas and extend services.
- Community organizations may make adequate managers of very small schemes or in areas of homogenous settlements. In mixed urban areas with systems serving over 5000 consumers, the utility needs to be involved. It can not be assumed that the utility will have resources to do this nor take on “community” water supply assets, once created, on its balance sheet.
- A realistic approach to using private sector participation in the urban water sector is critical; private sector needs to be compatible and compliment the Government’s objectives in the sector. Experience in the regions shows that there needs to be an effective local champion for PSP that will help build consensus. Stakeholder consultation is essential along with the full understanding of the different roles of the key players in the sector for: policy, regulation, and implementation.
- It is very important to conduct financial analyses at different stages in a project. These need to include affordability assessment; pricing and tariff assessments, and a review of current water access practices. These studies should lead to an evaluation of a realistic level of service given the utility’s and community’s financial and technical constraints.
- When reforms promise consumers better services, the reforms must be accompanied by adequate Government resources.

These lessons will be taken into account while developing and implementing the proposed project.

IDA is uniquely placed to help advance the reform agenda by maintaining a consistent policy message and dialogue. The Bank is active in introducing successful private sector options in WSS in Zambia and couples this with wide international sector experience. Bank support acts as a catalyst to strengthen Government's ability to partner with others and leverage available donor and investment financing. Major donor support to the Zambian urban water sector investments
follow a province by province approach. GTZ are active in the Southern and Northwest, and AfDB in the Central province. IDA compliments this approach with active support in the Copperbelt and in Lusaka provinces. Interest for co-financing has been shown by the Development Bank of South Africa (DBSA) in supporting water utility PSP efforts. A number of donors are exiting the water sector altogether as they change priorities to governance, health, education, transport and agriculture, or are concentrating on rural water, such as Danida, Irish Aid and JICA.

The GRZ’s interest in and commitment to the project is demonstrated by a Project Preparation Facility (PPF) request ($350,000) to proceed with the project preparation. The GRZ is also currently executing a Japan-PHRD grant (~$327,000) towards the preparation of this project. A separate PHRD grant (~$504,000) towards project preparation is being executed by the Bank on behalf of the GRZ. Further the GRZ has requested two PPIAF grants, administered by IDA, for a Private Sector Participation (PSP) Options Study and for a follow-on Public Relations and Consensus Building Program for Lusaka Water and Sewerage Company (LWSC).

2. Proposed objective(s)

The PDO is to ensure that water sector resources are effectively and efficiently used to contribute to poverty reduction. Specifically, the Project will: (i) consolidate and update the national water sector policy framework, and provide systems and facilities to ensure efficient utilization of the nation’s water resources for economic diversification and growth; (ii) provide increased access to improved water and sanitation services in urban areas in a more efficient and sustainable manner; and (iii) provide water resources management institutional support and selected local small works, to increase water security for poverty reduction at local level.

3. Preliminary description

The project has three components, with a total project cost of US$35 million. A SIL is proposed for the project to support the capital investment lending for civil works which is the largest component.

Component 1: Support for sector wide policy making and enhanced regulatory capacity in the Ministry of Energy and Water Development (MEWD) and Ministry of Local Government and Housing (MLGH) – (US$ 3 million): This component will support the emerging water resources agenda as well as the WSS policy making function through: (i) strengthening policy making capacity; (ii) supporting a Policy Reform Unit; (iii) TA support for legislative changes, and (iv) create and support capacity for monitoring and evaluation.

Component 2: Investments in water supply and sanitation in the Copperbelt and Lusaka Provinces – (US$ 26 million): This component will provide support for: (i) civil works for rehabilitation, networks extensions and small works; (ii) working capital for operational costs in the start-up phase of the lease contracts; and (iii) support to transactions costs for the selected PSP options.

Component 3: Investments in water resources management – (US$ 6 million): This component will support pilot water resources activities including catchment based management, rain water
harvesting and small works for water security in drought prone areas. Support will be provided for: (i) construction of 25 small schemes for water security; (ii) catchment management plans (iii) surface and groundwater monitoring facilities, and (iv) supporting studies.

4. Safeguard policies that might apply

At this stage, the project is likely to trigger Environmental Safeguard (OP 4.01) Policy and a “focused environmental impact assessment (EIA)” may be required. Since there is likelihood that it may also trigger Involuntary Resettlement Policy (OP/BP 4.12), the EIA TOR would also include an analysis of potential resettlements impacts.

5. Tentative financing

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6. Contact point

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