Designing Output-Based Aid (OBA) Projects Part 2

Ana Silvia Aguilera
Infrastructure Specialist

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Designing OBA Projects
The Basic Elements

A. Determining the output: What ***service*** is to be provided?

B. Reaching ***target population*** and selecting targeting methodology

C. Choosing an appropriate ***subsidy*** form

D. Determining the ***value of the subsidy***

E. Linking outputs to subsidy ***disbursement***

F. Organizing ***the institutional framework***

G. Evaluating and mitigating ***project risks***

H. Monitoring for ***results***

F. Organizing the Institutional Framework
Role of Service Provider

- Can be private entity, public utility, NGO, or Community-Based Organization
- Contracted to provide a certain service directly to consumers
- Allowed flexibility to design service "solutions" to maximize efficiency, based on set standards
- Takes performance and financing risk of delivering service

What performance risks do service providers take?

- Risks relating to infrastructure or other investments
- Operational risks
- Demand - or uptake risks

F. Organizing the Institutional Framework: Selection of the Service Provider

Design questions to ask:

- Does service provider (SP) serve a single market (concessionaire) or are there multiple SP in the market?
- Is there an incumbent or can the SP be competitively bid?
- Is the SP public or private?
  - May determine level to which SP is motivated by performance-based incentives.
- If limited pool of SPs, would capacity building create a larger pool?
- Is SP accountable for providing quality services?
  - Through contract provision or accreditation
- Does SP have:
  - Technical expertise to deliver service?
  - Financial capacity to support service implementation and “pre-finance” outputs?

F. Organizing the Institutional Framework: Does the SP have Access to Finance?(1)

- SP must be at financial risk, i.e. required to provide up front capital to finance outputs
- Consider SP's access-to-finance early in project design
- Financial sources: Limited availability and experience with OBA product, often very costly
- Innovative mitigation mechanisms required, but they are challenging to develop.
  - "Intermediate" outputs for subsidy disbursement
  - Extensive capacity building: local banks, local operators
  - Guarantees: USAID, Acumen, others

F. Organizing the Institutional Framework: Does the SP have Access to Finance?(2)

- Most onerous for small, local providers - flexibility in design required
- Consider impact of cost and terms of financing to avoid unaffordable tariffs or no bids to provide service

GPOBA's Water Supply in Uganda Small Towns Project

2 schemes used to support small local private service providers:

In small towns, where extensions from existing systems were required, a "pure" OBA approach was used:

- payment after connections and water service delivery

In green field rural growth centers, output-based payments are phased in:

- 60% disbursed during construction
- 40% disbursed with final connections and water delivery

F. Organizing the Institutional Framework: Role of Government and Regulators

- Support commercial viability: Tariffs must cover cost of operations and maintenance
- Clearly defined regulatory process and adjustment mechanisms
  - Tariff setting and adjusting policies
- Agreed procedures for dispute resolution to manage impact on scheme viability

F. Organizing the Institutional Framework
Providing for Independent Verification of Outputs: The Independent Verification Agent

- Principle: Transparency and no undue influence
- Verification is outsourced to:
  - Specialized consultancy firm (i.e. consultants, engineers, etc
  - (Local) Government
  - NGO/CBO or other local community representatives
  - Survey in the context of an impact evaluation
- Key issues
  - Independence – IVA should be a third party entity
  - Ease of measuring and verifying delivery
  - Training/skills required based on complexity of output to be verified
  - Recruitment of IVA is responsibility of implementing agency
  - Needs to be hired in time

G. Evaluating and Mitigating Project Risks – How would you allocate and mitigate risks during project design?

Risk	Mitigation
Performance Risk: Output is not provided on agreed terms	‣ Independent verification controls disbursement if performance is not met, but dependent on quality of verification ‣ Provide capacity building of SP prior to implementation
Payment Risk: Output is delivered but payment (subsidy) is delayed or withheld	‣ Proper linking of outputs with disbursements so cash flow to SP managed ‣ Using a fiduciary agent to disburse the subsidy payments rather than a Government agency
Demand Risk: SP has miscalculated consumer demand for the service (also called uptake risk)	‣ Sound market and demand studies ‣ Awareness building of targeted beneficiaries and through due diligence process (e.g., communication campaign)
Unit Cost Change Risk: Changes in unit cost due to inflation, commodity prices, forex or other factors out of SP's control	‣ Careful evaluation of unit cost at design stage ‣ Creation of a mechanism that allows for adjusting payments or variations of unit costs that cannot be passed through

G. Evaluating and Mitigating Project Risks

How would you allocate and mitigate risks during project design?

Risk	Mitigation
Collection Risk: Beneficiaries cannot or will not pay their portion of service charge	• Willingness-to-pay surveys and factoring collection risk in project design • Pre-payment or deposit required for service
Political Risk: a) Currency transfer restrictions; b) Expropriation and breach of contract; c) War and civil disturbance	• Mitigated through evaluation of government's and local authority commitment and track record • Purchase of political risk insurance
Regulatory Risk: Unwilling or unable to adjust tariffs in line with increasing cost of service delivery	• Assessed through due diligence process of regulator's experience and track record as well as clarity of regulation