

The Global Partnership on Output-Based Aid

Designing Output-Based Aid (OBA) Projects Part 1

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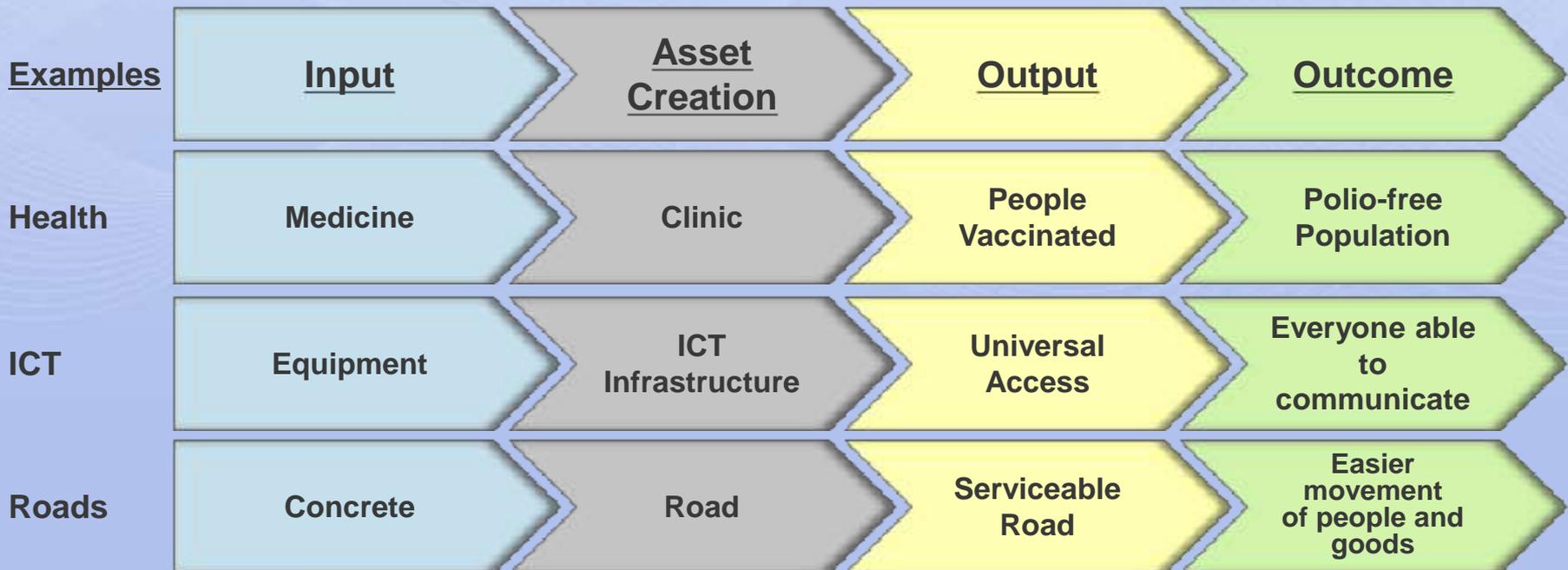
Designing OBA Projects

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**

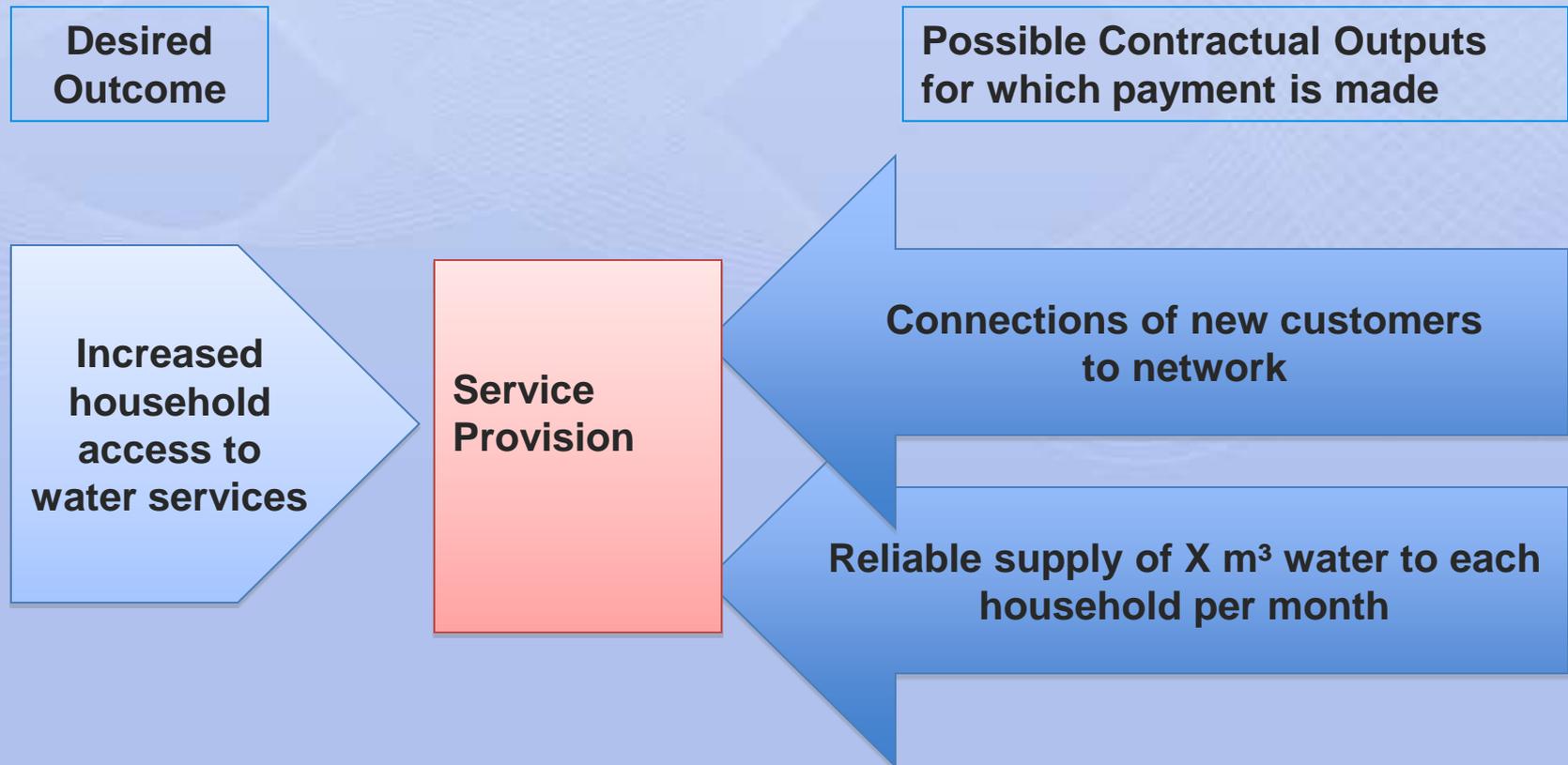
A. Determining the Output: Spectrum of Contracting out Service Delivery

OBA Objective: *Contract for an output as closely related to desired outcome as possible.*



A. Determining the Output: What Service is to be Provided?

- ▶ Clearly definable
- ▶ Easy to verify and measure
- ▶ Close to the desired outcome as is feasible



B. Reaching Target Population and Selecting Targeting Methodology (1)

- ▶ **Geographic targeting**
 - ▶ *Outputs available in poor areas*
- ▶ **Self-selection targeting**
 - ▶ *Aim is to subsidize very basic services demanded exclusively by the poor and which are less attractive to wealthier population*
- ▶ **Income-based targeting**
 - ▶ *Relying on existing social targeting mechanisms*
 - ▶ *Means-testing involves measuring a beneficiary's wealth to assess if subsidy is warranted*

Income-based targeting

- ▶ Can rely on existing social targeting mechanisms
 - ▶ Review quality of existing system
 - ▶ Check when classifications have been updated
 - ▶ Note potential trend of systematic underreporting of income
 - ▶ National statistics may not take informal income into account
- ▶ Proxy means testing tools (e.g., questionnaire, observations)
 - ▶ Can be done at low cost
 - ▶ Need reasonably high administrative capacity in implementing agency

Multiple targeting mechanisms can be combined

B. Reaching Target Population and Selecting Targeting Methodology (2)

Methodology selection is situation specific, depends on:

- ▶ Nature of service delivery in particular sector
- ▶ Type of social welfare mechanisms in place
- ▶ Cost benefit of targeting mechanism

C. Choosing a Subsidy Form (1)

Principle and Definition

Principle: *Subsidy must be targeted, linked to outputs and provide sustainable service.*

Definition of OBA subsidy:

The amount used to fill the “gap” between the total cost of providing a service to a user and the user’s ability to pay the cost.

C. Choosing a Subsidy Form (2)

- ▶ **One-off subsidies:** Most common form, used to expand access to targeted households through new connections
- ▶ **Transitional subsidies:** Used to support tariff reform; subsidy could fill gap between what user is deemed able and/or willing to pay and cost recovery level (e.g. long-run marginal cost) of tariff
- ▶ **Ongoing subsidies:** May be required where continuous gap between affordability and cost recovery exists, such as life-line tariffs

Depends on factors such as:

- ▶ Capacity for administering subsidy scheme
- ▶ Type of service to be subsidized
- ▶ Extent to which service providers are willing and able to be paid over time
- ▶ Availability of subsidy funding

D. Determining the Value of the Subsidy

- ▶ For a given output:

The value of the subsidy is determined as:

The difference between the unit cost
and
the amount that the user is willing and able to pay.

D. Determining Appropriate Unit Costs for Specified Outputs

- ▶ Actual cost of service often unknown at project design stage
- ▶ Mechanisms used to establish unit costs:
 - ▶ Approximation: Draw on benchmarks from incumbent suppliers
 - ▶ Competitive process: To reduce costs and provide market test of unit cost amount or payment required
- ▶ Use more than one source to avoid unique source bias (e.g., technical and market-based sources)
- ▶ Verify unit costs independently if service provider is incumbent

D. Determining the Value of the Subsidy

If through *competitive selection*, winning bidding variable established as:

- ▶ Greatest number of outputs for given subsidy amount
- ▶ Least connection cost per given amount of subsidy; or
- ▶ Minimum subsidy required to reach a number of outputs

In a tender for a rural electrification project (off-grid energy) in Bolivia, the winning bidder proposed 25% more beneficiaries for the fixed subsidy than the minimum required and a 40% reduction in the cost of solar home systems than an earlier UNDP project.

If *no competitive selection*, value of subsidy established through:

- ▶ Benchmarking; and/or
- ▶ Review of unit costs to provide service to specified standard

E. Linking Outputs to Subsidy Disbursement

- ▶ In contrast to disbursements for input milestones, disbursements are made on output delivery
- ▶ Considerations in setting disbursement schedules:
 - ▶ Ability of service provider to “pre-finance” outputs
 - ▶ Timeframe to deliver outputs includes demonstrating service sustainability

Uganda Rural Electrification Project

Outputs:

- ▶ A working electricity connection

Subsidy Disbursements:

- ▶ 50% after customer has working connection; and,
- ▶ 50% after 3 successful billing cycles