Output-based Aid in the Water and Sanitation Sector

Access to Market finance for African Water Utilities

Pretoria, August 9, 2006

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Presentation Structure

• What are output-based approaches?

• How can they be used to expand access to water and sanitation?

• Examples of the application of output-based approaches in the water and sanitation sector

• This workshop: how OBA could be used for some utilities to set up their first commercial loan
Delivery of Basic Service to the Poor

- There are **limits** to financing some basic services through **user-fees alone**
  - Affordability concerns
  - Public good characteristics
  - Infeasibility of imposing direct user-fees.

- Directing public funding to **inputs** used by **public sector providers** often does not achieve expected results
  - Poor targeting of intended outcomes
  - Weak incentives for efficiency & innovation
  - No or limited private financing leveraged.
Key Features of Output-Based Approaches

OBA is a strategy for channeling subsidies to support the delivery of basic services where:

- Disbursement of aid is made contingent to actual performance against the output indicators
  ➔ Pay for results, not pipes and pumps
Example of Contrasting Approaches

**Input-Based Approach**

- **Inputs** (e.g., power plants, schools, etc)
- **Service Provider**
- **Outputs**
- **Users**

**Output-Based Approach**

- **Private Finance**
- **Public Funding**
- **User-Fees** (when appropriate)

*Service provider mobilizes private financing*
*Public funding tied to service delivery*

Infrastructure Economics and Finance, April 16, 2004
Examples of subsidy arrangements

- **one-off subsidies**, for example to expand access through new connections, and/or
- **transitional subsidies** to cushion the move to cost recovering tariffs, and/or
- **ongoing subsidies** to targeted groups, such as low income consumers, for instance through delivery of payment to an operator of the difference between a life-line tariff and the full tariff.
OBA model for Transition Subsidies

Time-bound subsidies might be used to ease the transition to cost-covering tariffs
Cambodia OBA Water Project

- Civil war and social disruption: piped water supply covering only 1/3 of the population
- Communities relying on self-provision as well as increasing number of unlicensed private providers (including small networks)
- Customer studies show higher level of satisfaction in areas run by small private providers
The OBA model for subsidizing coverage expansion

- Traditional *input-based* approach: donors funding to subsidize civil works to connect new households
- Potential shortcomings:
  - Targeting?
  - Efficiency: competitive bids, but demand-driven?
  - Sustainability?
The Cambodia Water PSP scheme (15 years)

- 19 cities transferred to private operator under a *Design-Build-Lease* (DBL):
  - Non targeted subsidies through IDA credit ($27M) for Capex
  - Lease payment to Government
- 4 towns operated under OBA arrangement:
  - Targeted subsidy to connect the poor through IDA grant ($3M)
  - 2 operators
Cambodia: DBL versus OBA

DBL & OBA: private constructor is involved in future operation (demand & design risks)

DBL Disbursement

OBA Disbursement

OBA: 10% upfront, rest after connection

OBA scheme targets the poorest households
Morocco – Access to Services (INDH) pilot

Government objective: improve of access to services for peri-urban slums under the national INDH program

GPOBA pilot: Two existing concessions, Morocco and Tanger, one public utility in Meknes; envisaged national scale up
Morocco – Access to Services (INDH) pilot

• Government is grant recipient, Bank disbursement on outputs (OBD), through direct payment to service providers

• Set of unit prices based on independent benchmarking exercise, differentiated by utility, by service, by geography:

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<thead>
<tr>
<th></th>
<th>US$</th>
<th>per water connection</th>
<th>per sewerage</th>
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<td>RADEM (rural)</td>
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• Payments constitute 23-72% of total estimated efficient cost
Global Partnership on Output-Based Aid (GPOBA)

GPOBA is a multi-donor trust fund facility established in 2003 by DFID and the World Bank to:

- **Support** the design, implementation and evaluation of pilot OBA projects for the delivery of infrastructure and social services (e.g. design of model contracts, administrative arrangements, consensus and capacity building),

- **Disseminate** emerging lessons on issues relating to the role and application of OBA approaches (e.g. publications, workshops, conferences),

- And more recently (late 2004), to provide **direct funding for the subsidy component** of OBA projects via grant financing. The ability to fund subsidies during the early (relatively high risk) years of OBA projects will improve the options for long-term funding sources to the provision of public services in poor communities.
Other Examples: The OBA Record

- Approximately 30 known (mostly World Bank-driven) initiatives thus far
- 8 projects in the water sector at various stages of design and implementation
- Most projects have involved one-off connection subsidies
How could we use OBA?

- The main constraint with OBA is that service providers needs to pre-finance investment (they take performance risk):
  - An issue for public utilities
- But if 3-4 year local loans are available...
- E.g. Coverage expansion project
Global Partnership on Output-Based Aid (GPOBA)

For more information, visit:

www.gpoba.org

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