Results Based Financing Mechanisms: Experience from Output Based Aid

Partnership Forum Panel Sessions – Financing Transformations

CIF Partnership Forum
Cape Town, June 2011
Summary

- Results-Based Financing being talked about
- Output Based Aid (OBA) – what it entails
- OBA experience to date
- Findings on benefits of OBA approach
- Bangladesh example of OBA with SHSs
- Expanding local financing capacity
- Ensuring appropriate service level
- Mumbai example – framework for delivery at local level
Results based financing

- Payments to businesses or households after measurable pre-agreed actions have been achieved and verified.

- “financing” refers to payment to address the gap in funding between costs and revenues – the affordability or viability gap.
  - Subsidy to households so they can afford costs of connections
  - Cross-subsidy to utility to purchase/produce otherwise financially uncompetitive energy
OBA is part of a menu of instruments making up Results-Based Financing

- **Output-Based Aid (OBA)**
  - Access to basic infrastructure
  - Pro poor
  - Service providers reimbursed through subsidy for pre-financing of outputs
  - Independent verification of outputs

- **Performance-Based Road Contracting**
  - Combines construction, rehabilitation, and maintenance in one contract
  - Improved road efficiency
  - Service provider paid a fee by Govt based on quality of road
  - Independent verification of outputs

- **Output-Based Disbursement**
  - Improvement in efficiency of assets
  - Explicitly links cost of output (unit cost) to amount of financing
  - Govt typically provides pre-financing

- **Results-Based Financing in Health**
  - Includes a number of results-based approaches, such as incentive payments to health workers, health insurance, CCTs, and OBA.

- **Carbon Finance**
  - Payments on reduction in carbon emissions

- **Conditional Cash Transfers**
  - Incentive payment for desirable behavior
  - Paid to poor hhs

- **Programmatic Instruments**
  - Achievement of programmatic results
  - Use of country systems
  - Independent verification of outputs prior to disbursement
Traditional approach vs. results-based

**Traditional Approach**

- **Inputs** (such as materials)
- **Service Provider**
- **Outputs** (Services for End Users)

**Output-Based Approach**

- **Inputs** (such as materials)
- **Commercially Structured Finance**
- **Public Finance**
- **Outputs** (Services for End Users)

- **Government purchases specific “inputs”, builds assets and contracts out or provides services itself**
- **OBA reimburses the service provider after the delivery of outputs.**
Risk transfer: Subsidy Provider to Service Provider

- Payment only after Service Provider has delivered adequate level of service.
- Service independently verified before payments are made.

Several examples:
- Output-based Aid and Feed-in tariffs most relevant to clean energy/climate change.
Output based Aid

- Determine the service to be provided (the output)
- End recipients are targeted
  - low income
- Subsidies set at an efficient level
  - Designed on case-by-case basis with sustainability in mind. Process for determining what the level of subsidy should be.
  - Based on competitive process or efficient unit price discovery – not actual cost.
- Design appropriate institutional arrangements
- Projects continually monitored and regularly improved upon.
  - Everything is designed up front
  - Can be monitored.

Uganda: Access to Sustainable Water Services for the Poor in Selected Small Towns
Significant experience with OBA

- 2002: 32 projects identified - $1.5 billion WBG funding
- 2010: 131 projects identified - $3.5 billion WBG funding (excl. $2.8 bn government financing)
  - 66 projects identified outside the WBG
  - 51 Global Partnership on Output-Based Aid (GPOBA) projects, mainly in water, health and energy, of US$153 m value (committed)
- Evidence base is increasing (34 projects closed, 78 under implementation)
Snapshot of OBA in the WBG

WBG OBA Portfolio by Region

- AFR: 29%
- EAP: 9%
- ECA: 56%
- LCR: 3%
- MENA: 1%
- SAR: 2%

WBG OBA Portfolio by Sector

- Education: 61%
- Energy: 6%
- Health: 5%
- Telecom: 6%
- Transport: 20%
- Water & Sanitation: 2%
Lessons: Benefits of OBA Approach

- **Outcomes are targeted** — explicit ex ante determination of who should be eligible for the scheme
  - “Internalizing monitoring” by paying on outputs

- **Results focused** — all stakeholders have strong incentives to deliver service (and are only paid after doing so)
  - So far $1 of subsidy has leveraged $2 of private financing; varies by sector and region

- **Scope for Innovation and efficiency** — service outputs rather than work inputs are prescribed
  - Efficiency gains through competitive processes

- **Designed in sustainable way** — affordability assessment is carried out up front.
  - Encourages careful subsidy design
Specific case: Bangladesh Solar Home Systems

- Rural Electrification and Renewable Energy Development (RERED) Project.
- Since 2003, with a variety of grant donors including GEF, KfW, GTZ and latterly GPOBA. Two rounds of credit support from IDA.
- Targeted at off-grid consumers.
- 1 million connections in May 2011 (440,000 connections since May 2010).
- New round of IDA financing being processed for $172 million (630,000 new systems).
How it works: high level summary

1. At least 10%

2. Verification

3. Re-finance 80% of loan after verification

4. Financing

HH

PO

Supplier

SHS

IDCOL

Grant (GPOBA & others)

Credit (IDA & others)
Expanding local financing

- Need to pre-finance puts an onus on developing/leveraging the existing/local financing community.
- The explicit (OBA) contract with clear output requirements provides certainty for payment/re-financing.
  - POs were offering hhs credit at a rate of 12-15% with a repayment period of 3-5 years. By setting up the results-based lending facility offering 6-8% over 10 years, POs could extract their capital for use in further new projects.
- Rapid increase in the size of lending.
- Entry of several financial institutions into the market.
**Appropriate service levels**

- The project minimizes risk that its suppliers won’t perform by designing ‘outputs’ to reflect desired performance.
  - Includes post installation warranty.
- Government Agency (IDCOL) checks that this service requirement has been met before authorizing release of funds.
Case study: Mumbai wiring in slum context

Costs incurred by REL
- High tension network upgrading
- Low tension network upgrading

Wiring from Point of Supply to house
- Regulated connection charge

Wiring inside the house

Costs paid by consumer
- GPOBA subsidy
- GPOBA subsidy
- GPOBA subsidy
Sequence of events under the project

1. Slum dweller signs up licensed electricity contractor
2. Contractor informs REL and then installs connection
3. Independent verification contractor (IVC) verifies working connection and informs REL
4. REL makes subsidy payment to contractor
5. GPOBA reimburses REL

Prior training for slum dwellers
Prior training for contractors

REL reports to GPOBA on a quarterly basis
IVC provides verification reports to REL
IVC verifies REL report prior to payments
Provides framework for delivering access and energy efficiency at local level

- Service delivery meets technical and affordability requirements in areas that are beyond the responsibility of the regulated distribution company.
- Supports delivery of adequate basic services in an informal/slum environment.
- Ensures that the financial support is used efficiently and delivers targeted and effective results.
Mustafa Zakir Hussain
Senior Infrastructure Finance Specialist
The World Bank
mhussain2@worldbank.org

For information on OBA, visit:
www.gpoba.org