

## Output-based Aid for Urban Transport



Image: Michael Foley

**U**rban transport systems are crucial to economic and social development, and are particularly important for connecting poor populations to jobs, education, and health services. As the developing world rapidly urbanizes, there is an opportunity to build safer, cleaner, and more inclusive transport systems. In order to better understand the urban transport landscape and how output-based aid (OBA) might be applied most effectively in the sector, the Global Partnership on Output-Based Aid (GPOBA) undertook an urban transport study.<sup>1</sup> Completed in 2016, the study developed OBA pilot concepts and presented recommendations for the identification and preparation of OBA urban transport projects. This note discusses the study's main findings.

### The urban transport sector

Urban systems are complex, and the uniqueness of each urban environment and population make the design and provision of urban transport services a challenging task. For sound social and economic reasons, urban transport is usually subsidized through one or more means: infrastructure investment, subsidies to operators, or subsidies to users.

Whichever means is used, subsidy projects must take careful account of the need to balance the affordability of services, their density and frequency, and their financial sustainability for governments. Subsidies enabling lower fares, for example, are key to improving access for the

poor, but they don't address underlying system problems: being able to afford the bus is of limited benefit if bus routes and stops remain too far from where users live. Alternatively, near-guaranteed support for operators in the absence of obligations to produce additional or better services can disincentivize operators to improve profitability or take risks. Subsidies should be designed, therefore, to encourage efficiency and improved performance, while making services as inclusive and accessible as possible.

## The role of OBA

OBA is a form of results-based financing (RBF) that uses performance-based subsidies to improve access to and delivery of basic services for poor populations. By linking the disbursement of funds to verified services or outputs, OBA can help to improve service quality, transparency, and accountability.

According to the recent study, many common shortcomings of subsidy systems in urban transport can be addressed by designing or reforming them according to OBA principles. The aim of OBA transport projects—to improve access of poor populations to economic opportunities and services—may be approached in various ways, such as the upgrade of regulated transport services; the regulation and improvement of unregulated services; making transport more affordable for the poor; or improving transport infrastructure.

OBA projects should be part of sector-wide, long-term strategies aimed at improving access and mobility, aligned with the authorities' vision for the sector but focused on addressing access constraints facing the poor,

especially in cities where their transport needs may not be a priority for authorities.

## Targeting low-income users

OBA uses pro-poor targeting, which would be highly beneficial in the transport sector, where subsidies do not always translate into pro-poor impacts—particularly when they are paid directly to operators, resulting in a high rate of inclusion errors. Pro-poor targeting aims to reduce the main access-related barriers (e.g., affordability, supply, physical access) affecting low-income people, while supporting long-term transport sector improvements. Specific targeting methods should be assessed against the estimated cost of inclusion and exclusion errors. For instance, the cost of narrow individual targeting can be very high relative to the projected individual subsidy, and may be preferable to 'indirect' geographic or modal targeting only if a system already exists that allows for easy identification of the poor. However, even when a project's targeting criteria is modal and/or geographic, impact can still be carefully aimed at particular groups; subsidizing services at specific times on selected routes, for example, may benefit low-income women who travel daily to markets.

## Subsidizing infrastructure and networks

OBA subsidies are not long-term arrangements, but well-designed projects can support financially sustainable, positive changes that continue after OBA disbursements have concluded. Because many transport systems are already subsidized, the focus of an OBA project may

## OBA in Urban Transport: Key findings

- OBA uses pro-poor targeting, but even when individual targeting is not feasible, impact can be aimed at particular groups through modal and/or geographic targeting by, for example, subsidizing services at peak times on selected routes.
- Subsidies should support a balanced approach to affordability, density/frequency of services, and financial sustainability: lower fares alone, for example, may significantly improve access only if bus stops are near users and adequate numbers of buses run when most needed.
- OBA subsidies are not long-term, but projects can support long-term improvements. Such support might take the form of funding infrastructure investment, incentivizing sector reforms, or providing transitional funds during network improvements.
- OBA improves accountability by shifting performance risk to providers. But pre-financing and risk-bearing capacity vary among operators, and not all risks are under operators' control. OBA projects should avoid shifting excessive risk—for example, by transferring risk to the authorities, while ensuring that operators are adequately incentivized.
- Even when OBA projects support physical assets, indicators should be service-based: purchasing more buses does not guarantee improved service, so focus should be on how effectively the buses are put to use.

be less often on the ‘classic’ OBA model of subsidizing user fees and instead, for example, on providing transitional support to operators during network improvements, or incentivizing reforms that increase the financial autonomy of the transport service, such as through contractualizing subsidies against public service obligations. Contractualization is key to financial sustainability and to supporting institutional arrangements that ensure that improved performance can continue. OBA projects could fund one-off investments in infrastructure or equipment (taking care to ensure that operation and maintenance will be funded); incentivize stakeholders to improve an existing subsidy scheme; implement new monitoring technologies; or demonstrate the feasibility of a new subsidy scheme or approach through a replicable pilot supporting broad sector transformation that other financing instruments can build on. OBA could also help to leverage additional funding in the sector through co-financing arrangements.

Compared to other infrastructure sectors, the urban transport sector can be highly fragmented and tends to include many informal services and micro-enterprises, which complicates the implementation of subsidy schemes. It is worth noting that while expansion of the formal transport sector is often seen as a desirable outcome regardless of the developmental impact, unregulated operators constitute the bulk of supply in many cities, and there may be greater value in leveraging their energy and resources, and improving and regulating their services, than in subsidizing less efficient competitors.

## Performance risk

Because OBA subsidies are transferred to the service provider only when outputs have been achieved, performance risk is shifted to the provider, thereby improving accountability. In urban transport projects, risks may be tied to costs of infrastructure investment (which can fluctuate unpredictably), operations related to service delivery, and levels of demand. The transport sector contains multiple actors whose pre-financing capacities and willingness to bear these risks varies widely, along with their ability to withstand unexpected results of risk, such as cash shortfalls. Project design must take variations in risk-bearing capacity into account. For example, basing subsidy disbursements on passenger usage rewards efficiency, but it could also create unintended risk for the operator: if a targeted subsidy results in a large increase in ridership, the operator will have to purchase more vehicles, bearing the risk that additional riders may not materialize at the needed level. The structure of subsidies should avoid shifting more risk than is necessary



to provide an adequate performance incentive. In some cases, it may be more realistic to transfer risk not to the operators, but to the authorities, provided that operators are still adequately incentivized.

## Measuring impact

The impact of urban transport subsidies can be hard to measure. Baseline values for factors such as noise or greenhouse-gas emissions are often not available in developing countries, while a key positive outcome of transport projects—the economic benefits of population density—is complex to assess, due both to a lack of statistical data and the large presence of informal economies.

OBA projects are designed with clear, pre-agreed indicators for assessing the achievement of outputs. These indicators and outputs are independently monitored and verified throughout the project cycle. Output categories, and the indicators linked to them, could include: investment (e.g., buses or improved bus stops), production that reduces access barriers (e.g., number of additional vehicle/km or available seats/km during peak hour), or fare incentives, reflected in the payment of a subsidy per passenger paid to the operator. Capacity-strengthening is not itself an output but it can support performance that triggers disbursement.

OBA in the urban transport sector should focus on service-based indicators rather than investment indicators, even if the project supports physical assets. For example, although vehicles are an easy investment to verify, they could remain unused or inefficiently used, so it is better to measure service provided. Monitoring

service outputs may require rolling out ICT systems, which have the added benefit of helping operators to better manage transport networks. OBA projects offer a good opportunity to foster the development of these technologies.

It is important to be aware, when choosing project indicators, of systemic or external issues that can negatively impact operator efficiency; these include excessive regulation (e.g., fares that are too low, or mandated, unprofitable routes), unreliable fuel supply, or unpredictable congestion. Other efficiency-related factors are within operator control, such as competition for clients. OBA projects must ensure that in incentivizing operators to serve more clients, drivers are also incentivized to maintain safe driving practices. This may be done, for example, by mandating that operators pay drivers minimum fixed wages, or by contractual agreement that a certain amount of operator revenue goes toward vehicle maintenance.

## Conclusion

Designing or reforming public urban transport subsidy systems according to OBA core principles has the

potential to address many of their common shortcomings. OBA projects can create an enabling environment for better performance and service delivery by, for instance, contractualizing service standards for operators, strengthening transport policies, and building the capacity of transport actors. As OBA projects are limited in time, and public transport typically benefits from permanent subsidies, OBA will be most effective in the sector if projects are designed to ensure that changes incentivized by OBA can be sustained beyond the life of the project through such means as project replication, the leveraging of additional financing, or the conversion of a 'traditional' subsidy scheme into one based on OBA principles.

<sup>1</sup> Analysing the use of Output Based Aid (OBA) in Urban Transport, May 2016.

## About OBA Approaches

OBA Approaches is a forum for discussing and disseminating recent experiences and innovations in supporting the delivery of basic services to the poor. The series focuses on the provision of water, energy, telecommunications, transport, health, and education in developing countries, in particular through output- or performance-based approaches. The case studies

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