

## Output-Based Aid at Work in Public-Private Partnerships



**D**evelopment agendas and spending are now strongly guided by the Sustainable Development Goals (SDGs), which are a universal agenda designed to tackle the challenges of extreme poverty and the economic, social and environmental dimensions of sustainable development. Delivering basic infrastructure and services is a fundamental part of these challenges, especially for underserved communities. While the public sector will continue to play a crucial role in delivering infrastructure services, the public sector alone cannot meet the growing needs. Achieving the SDGs will require the combined

efforts of all parties, including more efficient investments by governments and donors, as well as significant private sector finance and expertise. A number of mechanisms exist for leveraging private financing and know-how to deliver development solutions—including public-private partnerships (PPPs) and output-based aid (OBA). This note details how OBA's emphasis on pro-poor targeting and accountability can add value to a PPP by ensuring that finance flowing from the private sector reaches those most in need, and offers three case studies in which OBA and PPPs have worked together.

## PPPs and Development

PPPs are long-term contractual arrangements that can be used to help governments make the most of scarce public funding by leveraging additional private finance for investment in infrastructure, and enabling them to harness private-sector innovation and efficiency for quality service delivery. The use of PPPs has steadily increased in the last two decades.<sup>1</sup>

The links between infrastructure and development are well established, including the impact of infrastructure on poverty alleviation, equality growth, job creation, health and education. Private investment underpins economic growth, with functioning, self-sustaining and responsive private-sector markets a critical part of the sustainability of development gains.

The motivations of private finance, however, are distinctly different from those of domestic public finance or of development actors, with private firms seeking investment opportunities based on risk-return considerations. Nevertheless, private business is becoming more aware of the interdependence of profits and development impact, and the idea that business solutions can deliver the two simultaneously has gained traction in recent years. As companies face a more complex array of trade-offs and risks, they are recognizing that their environment, society and governance responsibilities are integral to their long-term financial success, and are increasingly including in their long-term strategies considerations.

PPPs are rarely specifically designed to reach the poor, nor are they by definition aimed at supporting development or social inclusion. In fact, because the private sector continues to look for revenue from its activities, it is often less likely to be interested in servicing poor populations due to the perceived limited ability to pay for services. Governments wishing to attract the private sector as a development partner therefore still need to either lower perceived risks or increase potential returns.

## How OBA can add value to a PPP

OBA is a form of results-based financing (RBF) that facilitates access to basic services for the poor through the payment of subsidies that are disbursed against independently verified results. This innovative financing mechanism has been used to increasing access to basic services for poor populations. GPOBA projects have served over 9 million people in seven sectors. In an OBA project, service delivery is contracted out to a provider, either public or private. The provider pre-finances the service provision—for example, connection to a water-supply network or energy grid, a voucher-funded health service in a hospital, or waste collection. Once the service has been delivered and verified by an independent agent, OBA pays a subsidy,

generally designed to complement or replace access fees. This arrangement makes the service more affordable for the consumer, while the verification process (which can extend beyond the point of the initial connection to verify continued service) helps to ensure accountability and quality, meaning that users are more likely to continue paying for these higher quality services.

From the government's point-of-view, OBA can be used to leverage investment in infrastructure to provide services to reach all consumers. From the private sector provider's point-of-view, the incorporation of OBA within a PPP can enable access to new markets, mitigating the risk of expanding to serve low-income consumers. From a community perspective, OBA can help to provide the critical connection in accessing safe and reliable basic services.

One of the chief criticisms of PPP arrangements is the belief that large infrastructure projects cannot help the poor or bring local benefits. It is therefore critical to understand that OBA is, by design, aimed at bringing basic services to the poor and marginalized at the local level and that it uses careful targeting to ensure that services reach these populations. A blend of government investment, private sector finance, and OBA can be one effective way of achieving equitable and sustainable basic service provision in particular PPP contexts.

GPOBA's portfolio currently includes 29 PPP projects in the energy, water, sanitation, solid waste management, health, and ICT sectors; these projects are in 21 countries, including fragile and conflict-affected situations. GPOBA has worked with International Finance Corporation (IFC)<sup>2</sup> on five PPPs—in Lesotho, Liberia, Philippines, Uganda and the West Bank.

## Case Studies

### *Bangladesh Rural Electrification and Renewable Energy Project (RERED)*

Through the use of subsidies, OBA can encourage private sector interest, including through PPPs, in what have traditionally been less attractive markets, helping to build markets for products and services that private providers might not have been aware of or not ventured into due to potential risk of financial losses. This was the case in Bangladesh, where two OBA projects supported access to renewable energy technology for poor households in remote, rural areas of the countries.

A US\$13.95<sup>3</sup> million grant supported installation of 497,608 solar home systems (SHSs), benefitting over 2.2 million people, and a US\$1.1 million project supported provision of 41 solar irrigation pumps (SIPs), benefitting 1,356 poor farmers, as well as a 100 kW mini-grid, supplying energy to 253 poor rural households. These successful

PPPs were scaled up, and a US\$15 million grant is now supporting installation of 225,000 SHSs, two mini-grids with 500 connections, 330 solar irrigation pumps, and 6,000 biogas plants.

These projects are part of a larger renewable energy program begun in 2003 with support from the World Bank under the Rural Electrification and Renewable Energy Development Project (RERED). They have helped to develop a commercial market for SHSs and other renewable energy solutions through leveraging the capacities of microfinance institutions and the private sector.

The OBA projects have been implemented by the Infrastructure Development Company Limited (IDCOL), a government-owned finance company, in partnership with participating organizations (NGOs with a strong base in microfinance and private sponsors). IDCOL extended a credit line to the participating organizations and capital subsidies for the renewable energy technologies. The post-subsidy costs incurred by the participating organizations and project sponsors were recovered from customers under micro-credit schemes for SHSs and biogas plants or through tariffs in the case of mini-grids and SIPs.

Making renewable energy affordable to poor consumers through this combination of consumer credit, subsidies, and product choice opened the way to their widespread adoption. By leveraging the capacities of microfinance institutions and the private sector, these three projects that combine the PPP and OBA approaches have all supported the continued development of a commercial market for renewable energy solutions in Bangladesh.

### *Improved Electricity Access for Liberia*

Liberia is among the most impoverished countries in the world. Fifteen years of armed conflict devastated the country's institutions and infrastructure, with key electricity assets almost entirely destroyed. Today, access to grid power is around 10 percent and the majority of Liberians rely on costly and polluting alternatives to meet their electricity needs.

In 2011, GPOBA approved a US\$10 million grant to partly offset capital investment costs associated with building transmission and distribution networks for 21 low-income neighborhoods in Monrovia, and to subsidize the cost of connecting 16,806 poor households to the grid in those neighborhoods. The GPOBA project is part of the World Bank-financed Liberia Electricity System Enhancement Project (LESEP), which supports network expansion in Monrovia and the enhancement of power generation facilities, and complements funding provided by IDA and the Government of Norway for the reconstruction of Monrovia's grid. The GPOBA grant recipient and service provider is the Liberia Electricity Corporation (LEC), a public power company, which is operating under

a management contract with an international private operator, Manitoba Hydro International. This project faced implementation challenges, including those brought on by the Ebola crisis, but is continuing to connect households to the grid, and to date 14,033 households have been connected, benefitting 70,165 people.

### *Improved access to water services in Metro Manila*

In the mid-1990s, metropolitan Manila was facing a water crisis, with poor piped supply, dilapidated infrastructure, and a rising population. To address this crisis, the Government of the Philippines (GoP) passed legislation that led to private sector involvement in water and sewerage service provision. A PPP was formed in which the private entity Manila Water Company (MWC) took over the operation of the East Zone of Manila in a concession arrangement with the state-owned Metropolitan Waterworks and Sewerage System. MWC increased 24-hour water service coverage to 98 percent of its network area and provided new connections to poor households through a special program in which the company paid for investment in the network and households paid for the service connection by installment. In time, however, it became clear that poorer households were unable to pay the connection fee in full.

A US\$2,850,000 GPOBA project was embedded in the existing PPP concession arrangement and in the larger network expansion effort by MWC, building on MWC's service expansion to low-income communities through the use of OBA subsidies to fund water connection charges. The GPOBA subsidy was paid directly to the MWC as a single payment, conditional on the independent verification of three months of satisfactory service delivery. During project implementation, revised tariffs resulted in lower connection fees, and when the project closed in 2013, 28,563 OBA-subsidized connections had been achieved, exceeding the project's initial target of 21,000, and benefitting 142,810 residents.

## **Conclusion**

In the coming years, the huge potential of the private sector will have to be mobilized in order to meet the growing needs for services and infrastructure, which the public sector alone cannot meet. In a well-designed PPP, the goals of the public and private sector can be accommodated and balanced, addressing and improving upon inadequate infrastructure that hampers economic growth. OBA, with its focus on social inclusiveness, can play an important role in PPPs. Through pro-poor targeting and emphasizing accountability in service delivery, OBA can help to ensure that services and the economic growth

benefits that result from improved PPP infrastructure can reach poor and vulnerable populations.

## Sources

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<sup>1</sup> PPPs are now used in more than 139 developing countries, contributing about 15–20 percent of total infrastructure investment.

<sup>2</sup> IFC, a member of the World Bank Group, is the largest global development institution focused exclusively on the private sector in developing countries.

Note: All monetary amounts are in US\$ unless stated otherwise.

## About OBAApproaches

OBAApproaches 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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