

8 Specific Pro-Poor Activities in PPPs

The private sector is seen as a potential source of the expertise, efficiency, and capital, which are required to improve and expand service, but which are often lacking in the public sector. In many cases, the private sector has been able to successfully partner with public utilities to the advantage of consumers. However, experience has shown that many private operators were unable or unwilling to improve or expand services to low-income groups (LIGs), at least in the short to medium term. The underlying cause is that the private sector may have little incentive to extend services to low-income areas due to the high cost of providing the service and low profits due to lack of a payment culture, lack of tenure, low consumption, and low-cost structures for those customers.

The concerns voiced by consumers, NGOs, and representatives of civil society have translated into new, targeted approaches to the needs of LIGs within the rubric of PPP structures. The most explicit of these approaches is a new approach called output-based aid or OBA. However, there are other ways in which the PPP process and the basic forms of PPP can be approached from a pro-poor perspective. When this approach is combined with tailored interventions to alleviate service constraints, PPPs can provide adequate incentives to the private sector, involve the LIGs, and balance the financial and social risks and rewards to all stakeholders.

8.1 Pro-Poor Characteristics of PPP Options

Reexamining the range of options and any inherent advantages or disadvantages in terms of service to the poor is important. Then it is possible to consider specific pro-poor interventions that might be attached to a process. As a component of a reform package, a PPP can be tailored to address specific reform objectives. The PPP process and contract can therefore be tailored, more or less, to the requirements of LIGs to the degree desired and feasible.

Service and management contracts

The operator has no responsibility to finance operations or to invest in the system and payment is not fully tied to the amount of tariff revenue collected. All resources apart from specific expertise are provided by the public sector, and the operator can only make best use of those resources provided.

As the operator has no responsibility to invest in the system, these contracts, by their very nature, cannot require the operator to extend or provide service to low-income areas. How-

ever, the contracts can require expertise in social issues and in developing and implementing any funded low-income strategies.

Lease and affermage contracts

It is possible to structure compensation incentives into a lease that encourages providing service to LIGs within the served area. However, extension of the system into unserved areas remains with the public sector (or as negotiated) and may not be a priority for either public or private sector. If the low-income areas fall within the existing service area, the operator may be motivated to provide service for the sake of increasing tariff revenue or remuneration. However, these areas may be a lesser priority than other consumer groups within the service area.

Concessions

Concessions provide the operators with an inherent incentive to provide service to as many customers as possible. Under the compensation scheme of a concession, the operator is allowed to keep most or all of tariff revenues at an agreed rate (or formula) for a unit of water. The operator thus is motivated to sell as much water as possible, potentially to LIGs as well as to others. However, the operator also has an incentive to keep operating costs as low as possible to maximize the profit margin. The operator will thus seek low-cost ways to provide service and may be reluctant to expand the network, particularly into areas that are geographically challenging or where the culture of payment is uncertain.

Related to the compensation issue is the scope of a concession. Under this contract type, the operator typically has the obligation to finance and operate not only the existing system, but also any expansion of the system. Relevant to LIGs, the operator would have to determine through cost-benefit analysis that expansion to unserved areas will generate a sufficient return on investment. If the government wants a concessionaire to prioritize expansion to low-income areas, this should be specified in the contract or an incentive should be provided. Box 17 highlights Peru's incentives for rural telephony expansion.

8.2 Pro-Poor Interventions in the Context of PPPs

To encourage the operator to serve LIGs under PPP, it is vital to consider low-cost mechanisms of providing service, pricing structures that encourage customer payment, low-cost financing for system extension, and other contract mechanisms relevant to the specific characteristics of the low-income population.

PPP arrangements might be made more responsive to the requirements of low-income consumers in many ways. These include both contract provisions or content and changes in the overall approach to the reform agenda. Specifically:

Box 17: Incentives for Rural Telephony Expansion in Peru

As an incentive for private telecommunications operators to expand service to rural areas of the country, the Government of Peru has structured public–private partnership (PPP) arrangements that award a subsidy for pay phones installed in predefined target areas. The program uses a “least subsidy” approach to achieve the desired results for minimal cost. Operators bid for the right to provide services to rural areas, and the winning bidder is that who offers to install the phones for the least subsidy. Payment of the subsidies is linked to performance, with part paid upon award of the contract, part once the pay phone has been installed, and the remainder in semiannual installments over the life of the contract, with these payments tied to the operator’s achievement of key performance indicators. This structure not only provides incentives to operators to extend service to low-income areas, but places equal priority on the maintenance of infrastructure and the quality of service to low-income customers.

Source: Cannock, Geoffrey. 2001. Telecom Subsidies: Output-Based Contracts for Rural Services in Peru. *Viewpoint Note No. 234*. Washington, DC: World Bank, Finance, Private Sector, and Infrastructure Network.

Reform framework

- The policy commitment to LIGs must be clarified and strengthened.
- There needs to be common agreement on which segments of the population constitute LIGs, as well as which institutional entity is responsible for updating the definition of LIGs and monitoring their access to service.
- Current data should be collected on LIGs in terms of service, preferences, and access. These data would be used to inform strategies and coverage targets and set a baseline for measuring progress. Consultation within the LIG community should be ongoing to understand current service levels, constraints, and preferences.
- There should be a frank consideration of the role of existing or potential small-scale providers or informal service providers and the potential to use those providers for the short to medium term to fill gaps in service until coverage through PPP is expanded.
- The existence of any legal prohibitions against serving informal settlements or to tailoring service standards to the constraints of a community should be reexamined.

Financial considerations

- The government’s policy on subsidies should be reexamined in the context of cost recovery goals under PPP.
- There should be consideration of whether connection fees are a greater disincentive to network service than the ongoing payments for service. If so, the connection fee should be reexamined in terms of level and application.
- Mechanisms to facilitate payment, such as prepaid meters, increased paypoints, frequent billing, and others should be considered.

The PPP contract

- The contract should include the flexibility to implement the right level of service appropriate to the financial capability of the LIGs, with potential to upgrade.
- Likewise, the technology and construction standards should be appropriate but low cost.
- The potential for LIGs to contribute in-kind through labor should be considered.
- The contract should allow for partnership or coexistence with small-scale providers or communities where appropriate to reach a particular LIG.

The PPP bid process

- If bidders were to have obligations in terms of LIG service, they require reliable data on LIGs and site visits.
- Bidders can be required to present their past experience in serving LIGs and to explain their present strategy under the PPP contract at hand.

8.3 Output-Based Aid Contracts

OBA provides a way in which international financial institutions (such as the Asian Development Bank) can directly structure its financing to benefit poor people, even when the service provider is a private company.

OBA is the use of explicit, performance-based subsidies funded by the donor to complement or replace user fees.⁸ It involves the contracting out of basic service provision to a third party—such as private companies, NGOs, CBOs, and even public service providers—with subsidy payment tied to the delivery of previously specified outputs. This means that targeted and valuable subsidies to disadvantaged populations are funded through donor funds. The private partner, meanwhile, can only recover this funding by achieving specific performance outcomes. A global multi-trust fund was created in 2003, the Global Partnership for Output Based Aid, to provide increased access to reliable basic infrastructure and social services to the poor in developing countries through the wider use of OBA approaches (see Box 18 for information).

Generally, OBA schemes finance three types of subsidies:

- **One time.** These would include subsidies for connections with the collected user fees covering longer-term operation and maintenance costs. These have been the most common under OBA schemes to date.
- **Transitional.** Transitional subsidies are used to ease the transition to full cost recovery tariffs.

- **Ongoing.** Ongoing subsidies are linked to a sustainable source of funding such as general tax revenues, earmarked tax revenues, or explicit cross-subsidies. These subsidies are used to complement the existing funding source. This has been less used and requires longer disbursement periods.

OBA also transfers risk to the operator in several ways. First, OBA links payment of the subsidy to performance outcomes, maintaining pressure on the operator to reach agreed upon service and commercial targets. Second, OBA schemes determine and pay the total level of subsidy ex post. Thus, the operator runs some risk that payment will not be made by government as agreed.

Typically, OBA payments relevant to pro-poor service would be linked to outcomes related to consumption and coverage expansion, but OBA schemes are also applied to BOT projects that might have an indirect, positive impact on the poor.

For OBA to work, there has to be a process for monitoring and verifying delivery of the specified outputs, to pay out an accurate subsidy.

Box 18: The Global Partnership for Output-Based Aid

The Global Partnership on Output-Based Aid (GPOBA) is a multi-donor trust fund created in 2003 and administered by the World Bank, with funding support from the World Bank, the United Kingdom's Department for International Development, the International Finance Corporation, and the Netherlands Government. The goal of GPOBA is to provide increased access to reliable basic infrastructure and social services to the poor in developing countries through the wider use of OBA approaches. GPOBA will demonstrate and document OBA methods of supporting the sustainable delivery of basic services (water, sanitation, electricity, telecommunications, transportation, health, and education) to those least able to afford them and to those currently without access. Currently, GPOBA funds are eligible to support the following:

- Funding of output-based payments under OBA schemes to facilitate the piloting of innovative, small-scale projects;
- Studies and other inputs to assist in the design, implementation, and evaluation of particular schemes intended to pilot the application of OBA approaches to the delivery of eligible services; and
- Publications, workshops, and conferences to help identify and disseminate emerging knowledge on issues relating to the role and application of OBA approaches.

For more information on OBA, visit the GPOBA website at www.gpoba.org.