

OBA Diagnostic Tool

PART ONE Initial Assessment

The OBA Diagnostic Tool assesses the suitability and feasibility of a proposed Output-Based Aid (OBA) scheme. It is designed to provide high-level guidance to policymakers and practitioners when considering the *suitability* of OBA schemes in a given sector and/or country. It can also be used as a basis for discussion with government counterparts, country teams, service providers, and others to facilitate a decision on the *feasibility* of OBA and its application in a given context.

The Diagnostic Tool can be used in a Two Part Approach, allowing an initial screening to discuss and evaluate the scheme for potential viability, against six critical factors in the areas of Institutional Capacity & Arrangements and Financial Mechanics. If the scheme is shown to be potentially viable by meeting the six critical requirements, then a further detailed analysis is made, including Regulatory & Legal Environment factors.

This document (Part 1 of the Diagnostic Tool) provides an initial assessment based on the six critical requirements for an OBA scheme.



What is OBA?

The traditional approach to aid is input-based. By contrast, OBA links payment to performance. It ties the disbursement of funding (in the form of subsidies or grants) to the achievement of clearly specified results—or “outputs”—that directly support improved access to basic services, such as infrastructure (e.g. water, electricity, etc), health, and education. By specifying the outputs to be delivered, and paying subsidies or grants to service providers only when those outputs have been delivered, OBA shifts performance risk to the service provider, while better targeting funds to intended beneficiaries.

What are the Objectives of the Diagnostic Tool?

The Diagnostic Tool aims to assess the degree to which the minimum standards for a given OBA scheme can be achieved by examining the proposed scheme and its key stakeholders to determine the

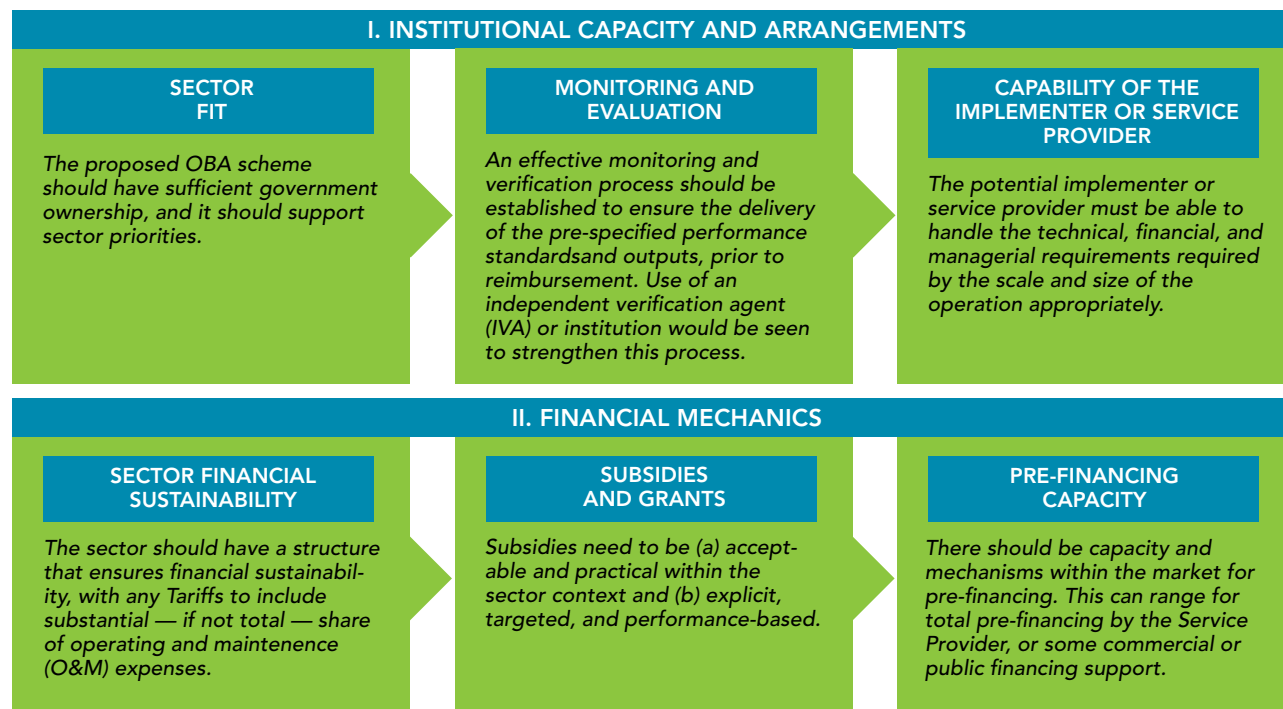
suitability and feasibility of the scheme in a given context. The Tool examines the institutional capacity and arrangements, and the financial mechanics of a proposed scheme. The Tool is not meant to be prescriptive; rather, it allows practitioners ample room to exercise judgment, discretion, and informed decision making about the particulars of the OBA scheme under consideration. Although the Tool focuses mainly on the application of OBA in infrastructure schemes, it can also be used to assess OBA schemes in other sectors, such as health and education.

How Does the Diagnostic Tool Work?

Part 1 of the Diagnostic Tool focuses on two key areas affecting any scheme to be implemented:

- I. **Institutional Capacity and Arrangements:** The institutional set-up, how the institutions can support the proposed OBA scheme, and the overall implementation capacity of both the institutions

SIX CRITICAL REQUIREMENTS



and the proposed implementing agency, whether public or private.

II. **Financial Mechanics:** The ability of the sector to support the scheme financially, meet the financing and pre-financing needs, make effective use of subsidies, and link payment to performance.

Under these two headings, the Tool focuses on **six critical requirements** that must be considered. Their collective absence or “low” presence—or an inability to mitigate gaps in these requirements—would indicate that practitioners should not proceed with the scheme. These six critical requirements and the order in which they should be considered are illustrated in the flow chart (below left).

How to Use the Diagnostic Tool

The Tool is presented in the form of a table (see below). The areas to assess are outlined in column 1. For each critical requirement, the practitioner should answer all the assessment questions /factors (column 2) and then compare the responses and analysis with the minimum OBA standards (column 3). The practitioner should then use the color-coded options to rate the degree to which the minimum OBA standards exist for the scheme in question (column 4). Mitigating factors, which may be needed in some cases, are presented in column 5.

How is the Rating System Used?

The practitioner should conduct the assessment block by block, not by individual question. For example, under “Institutional Capacity and Arrangements,” all the questions relating to the “Technical Capacity of the Service Provider” must be answered in order to determine whether the proposed scheme’s ability to meet the minimum OBA standards for that area is low, medium, or high.

What Does the Color-Coding Mean?

The three colors signal whether the practitioner should proceed, add some mitigating factors or stop considering the OBA scheme.

Green = High: This is a signal to proceed. The practitioner confirms the presence of the minimum enabling environment or related standards.

Yellow = Medium: This is a signal to add some mitigating factors. The practitioner may assess and implement some mitigating factors to strengthen the feasibility of OBA in a particular context, depending on how critical the minimum standards are to the success of the OBA approach and the likelihood of success of the mitigating effort.

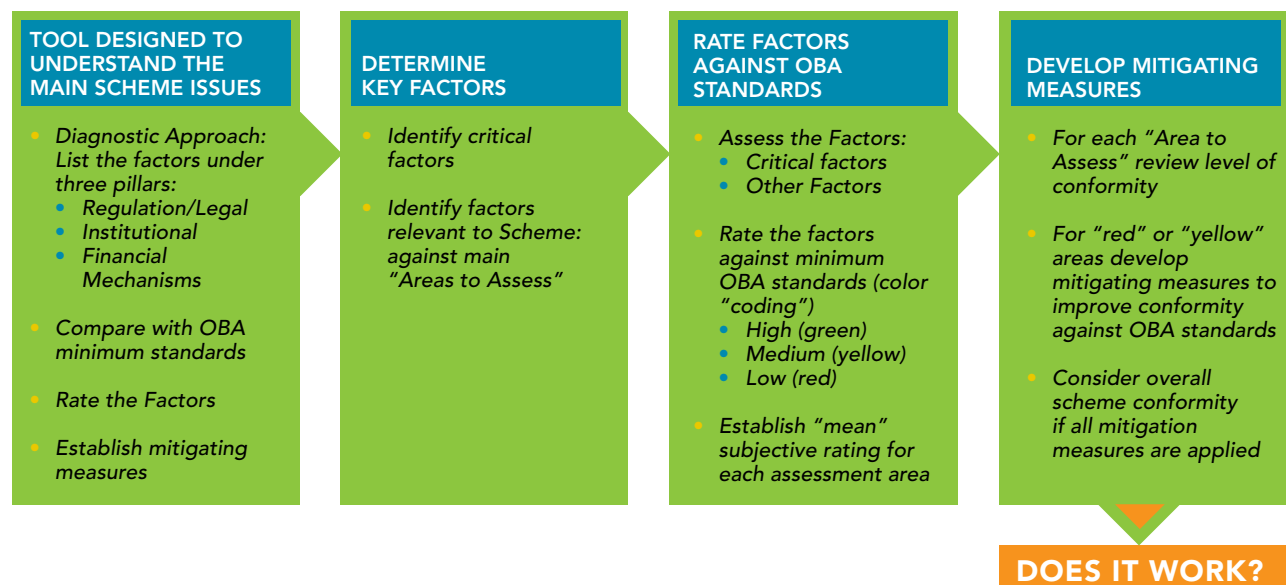
Red = Low: This is a signal to stop. The practitioner should stop considering the scheme unless certain minimum enabling environment or related standards can be strengthened.

What Do the Ratings Mean, Taken Together?

With the aim of making an overall assessment, the practitioner should tally the number of red, yellow, and green boxes and see which color predominates. The predominant color will indicate whether the scheme is viable.

- **Mostly greens:** The practitioner may decide to proceed, with assurance that certain critical requirements/minimum standards are present, and that an OBA approach is likely to be suitable in this environment, if designed properly.
- **Mostly yellows:** The practitioner may decide to proceed, knowing that certain critical requirements/minimum standards can be strengthened with remedial actions. The practitioner should appraise the likelihood of success with the use of

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a set of mitigating factors. Parallel implementation or proper sequencing of a collective set of remedial actions may also be feasible.

- **Mostly reds:** No OBA scheme can function without a well designed, results-based financing mechanism. Unless the critical requirements/minimum standards are present, the environment is not conducive to an OBA approach.

Next Steps

If a scheme satisfies the six critical requirements, with any necessary mitigating measures in place, the practitioner can proceed to a more detailed analysis using **Part 2 of the Diagnostic Tool (Full Analysis)**. This second stage includes further questions on Institutional Capacity and Arrangements and Financial Mechanics, as well as an assessment of the Regulatory and Legal Environment for the scheme.

Staff of the Global Partnership on Output-Based Aid (GPOBA) can assist practitioners with Parts 1 and 2 of the Diagnostic Tool process. Please contact gpoba@worldbank.org for more information.

Practitioners can also access further resources on the OBA Diagnostic Tool at: <http://www.gpoba.org/gpoba/resources-practitioners>.

Summary of the Diagnostic Tool Approach

- Understand main scheme issues.
- Identify the assessment factors for each area.
- Rate factors against OBA minimum standards (green/yellow/red).
- Assess whether using mitigating measures would improve the ratings (if necessary) and make OBA feasible in a given context. Examples are given, but this list is not comprehensive, and the factors are not guaranteed to succeed in all contexts. Practitioners must use their judgment to determine which mitigating factors might apply to their specific scheme.
- Determine whether the scheme as a whole meets the six critical requirements.

1. Areas to Assess	2. Assessment Factors	3. Minimum OBA Standards	4. Rating Against OBA Standards	5. Mitigating Factors
I. INSTITUTIONAL CAPACITY AND ARRANGEMENTS				
<p>Government commitment. Alignment of the proposed scheme with sector priorities and capacity.</p>	<p>Is the government committed to the program and scheme and willing to invest its resources? Is there a champion who will support the scheme? What level of government is responsible? What are the responsibilities of other levels of government?</p> <p>Which key issues constrain extension of services to the poor?</p> <p>Does the proposed OBA scheme support sector priorities?</p> <p>Are other development partners willing and ready to provide coordinated support for the government's program and OBA scheme?</p>	<p>Critical Requirement 1. Sector Fit</p> <p>The proposed OBA scheme should have sufficient government ownership and should support sector priorities.</p>	<p>Low</p> <p>Medium</p> <p>High</p>	<p>OBA schemes that do not have sufficient government ownership and are not aligned with sector priorities will be very difficult to implement. Is mitigation possible? If not, stop!</p> <p>To strengthen commitment, encourage the government to co-finance the scheme and ensure that government contributions are recognized and publicized.</p> <p>Proceed, if satisfied with other minimum standards.</p>
<p>Government commitment. Alignment of the proposed scheme with sector priorities and capacity.</p>	<p>Does the government agency have the administrative capacity to manage an OBA contract and subsidy or grant disbursement (e.g. to mobilize resources, design contracts, formulate criteria for selecting schemes, award contracts, monitor and verify service delivery and outputs, and pay service providers)?</p> <p>Could the OBA scheme use the existing country monitoring and evaluation (M&E) system? Is there sufficient capacity to hire an Independent Verification Agent (IVA) that can assess the quality of services without too much reference to the inputs used?</p> <p>What are the fiduciary capacities and arrangements (e.g. kinds of existing contracts, quality of country systems)? Are they effective?</p>	<p>Critical Requirement 2. Monitoring and Evaluation</p> <p>An effective monitoring and verification process should be established that ensures that the service provider has delivered the pre-specified performance standards and outputs, prior to reimbursement. Use of an independent verification agent (IVA) or institution would strengthen this process.</p>	<p>Low</p> <p>Medium</p> <p>High</p>	<p>The concerned government agency should have the administrative capacity to manage an OBA contract and subsidy or grant disbursement, or sufficiently qualified private firms should be available that can be hired. Is mitigation possible? If not, stop!</p> <p>For OBA capacity building: Early preparation to implement the scheme is needed, to obtain buy-in from key players and change existing mindsets—especially if approach is relatively new to the country, the administrator, or the service provider.</p> <p>If there is no IVA: Identify an entity (e.g. auditor general, scheme steering committee) to monitor the providers' service obligations and to use various audit mechanisms (to audit product, technical, and service quality).</p> <p>Proceed, if satisfied with other minimum standards.</p>
<p>Technical capacity of the service provider</p>	<p>How qualified and experienced are the technical decision makers?</p> <p>Is there enough appreciation and understanding of OBA?</p> <p>Who is responsible for quality control and how is it ensured?</p> <p>What kind of schemes has the service provider undertaken in the past few years? How accurate are estimated costs and schedules? Are these schemes meeting intended objectives?</p> <p>Is the technical staff able to handle critical technology?</p> <p>Which types of technology are used (e.g. treatment processes)? To what extent are the systems operable and economical? Is the technology suitable given the level of skills and funding?</p> <p>Does the service provider have the capacity to provide IVA? How good are the provider's fiduciary capabilities and arrangements?</p>	<p>Critical Requirement 3. Capability of the Implementer or Service Provider</p> <p>The potential implementer or service provider must be able to appropriately handle the technical, financial, and managerial requirements necessitated by the scale and size of the operation.</p>	<p>Low</p> <p>Medium</p> <p>High</p>	<p>The service provider must have the relevant technical capability to implement the scale of the proposed OBA scheme. Is mitigation possible? If not, stop!</p> <p>If no local service provider is solely qualified, allow for domestic-international alliances in service areas that are large enough to interest international bidders.</p> <p>Engaging specialized private sector contractors or business development services agents can help providers deliver more efficient services to beneficiaries.</p> <p>Use technical assistance funds to train implementers in their OBA skill gaps.</p> <p>Proceed, if satisfied with all other minimum standards.</p>

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II. FINANCIAL MECHANICS				
Sector commercial structure: tariffs and cost recovery	<p>Do overall tariff levels cover O&M average costs?</p> <p>Is there ability and willingness to pay?</p> <p>Is there already a set subsidy or grant that covers the gap of cost recovery? Is it viable?</p> <p>Are there co-financing arrangements?</p> <p>What happens if prices go up? Can the tariff be adjusted based on an analysis of its effects on supply and demand?</p>	<p>Critical Requirement 4. Sector Financial Sustainability</p> <p>The sector should have a structure that ensures financial sustainability, with any tariffs covering a substantial share of operating and maintenance (O&M) expenses—if not all such expenses.</p>	<p>Low</p> <p>Medium</p> <p>High</p>	<p>Without O&M coverage and users' tariff payments, the long-term provision of the service will be very difficult to sustain. Is mitigation possible? If not, stop!</p> <p>To mitigate tariff and service mandate risk, it is necessary to have time-bound service contracts that clearly delineate service areas, tariff levels, and performance standards.</p> <p>If there is no subsidy or grant: Ensure high levels of demand from areas with high household density and a strong local economy.</p> <p>To handle changes in unit cost, include a contractual amendment to cover unit subsidies or grants when unit costs increase significantly beyond the control of the recipient.</p> <p>Proceed, if satisfied with all other minimum standards.</p>
Potential design of subsidies and grants	<p>Can the subsidies and grants be explicitly recognized and all the details identified?</p> <p>Could the subsidy or grant continue over a given period?</p>	<p>Critical Requirement 5. Subsidies and Grants</p> <p>Subsidies and grants need to be: (a) acceptable and practical within the sector context, and (b) explicit, targeted, and performance-based. Further, they should be clearly defined, with a financing scheme that can be shown to ensure availability and sustainability of subsidies and grants. The subsidies and grants can range from bridging the financing gap between the full cost of service delivery and the amount that the users can and will pay, to covering the buy-down of capital costs for service providers.</p>	<p>Low</p> <p>Medium</p> <p>High</p>	<p>No OBA scheme can function without a well designed, results-based financing mechanism. Is mitigation possible? If not, stop!</p> <p>Some aspects of subsidy and grant design can be addressed at a later stage. Not all OBA schemes have a user fee element. Where subsidies and grants are needed to cover capital investments or to bridge the financing gap, they should be explicit, targeted and performance-based. Also, various donors have different requirements relating to subsidy or grant efficiency, internal rate of return, and the like.</p> <p>To mitigate demand risk: (i) Require beneficiaries to apply for capital grants and provide co-financing to bolster their sense of commitment and ownership; (ii) Design public outreach activities to adequately communicate the benefits of the OBA approach.</p> <p>Proceed, if satisfied with all other minimum standards.</p>

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II. FINANCIAL MECHANICS				
Financial and performance risk management	Can the providers assess and mitigate performance, financial, and other risks?	Critical Requirement 6. Pre-financing Capacity The scheme implementer should be capable and mechanisms should be available within the market for pre-financing investments before output-based disbursements are made. This can range from full pre-financing by the service provider, to some other commercial or public financing support, with a substantial proportion of the subsidy amount paid on delivery of verified outputs.	Low	Without the ability to pre-finance the scheme and to manage risks, the service provider will find OBA difficult to implement. Is mitigation possible? If not, stop!
	Can the provider pre-finance the scheme or find resources to pre-finance?			Medium
	Are the sources of financing likely to continue over a given period?		If service providers are hesitant to take on the financial risk: Donor involvement could give service providers more confidence that the output-based payments will be reimbursed.	
	For public-funded portion of the OBA scheme, are the fiscal risks measured? Are the obligations of the OBA scheme valued to estimate the expected payments during the span of the investment?		To minimize excessive assignment of risks to implementers/providers: A medium-term service contract (MSC) can provide exclusive access to subsidies and grants for four years after installation, after which users and suppliers may "graduate" to open competition.	
Is there a financial intermediary that can establish and manage a performance-based financing arrangement?	To motivate investors to take performance risks: (i) The return on the investment must justify the risk being taken; (ii) The potential for increasing customer outreach and related business must be promoted.			
Is the financing arrangement reliable? Could there be mechanisms to mitigate payment risk?	If financial intermediary capacity is limited, the gap can be filled by alliances between: (i) Institutions with traditional skills in microfinance that work with groups and communities; (ii) Larger financial institutions that have more sophisticated credit analysis skills.			
			High	Proceed, if satisfied with all other minimum standards.

Acknowledgments

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