Results-based approaches in the energy sector

Learning Event, May 7, 2012

Background

Results-based approaches are receiving increasing interest from client and donor countries, but their deployment in the energy sector has been limited compared to other sectors. The Energy Sector Management Assistance Program (ESMAP) has initiated a work program to assess how results-based approaches can be used to improve outcomes and scale up financing for energy sector development.

As part of this work program ESMAP hosted a conference on May 7, 2012 during its annual Knowledge Exchange Forum to share lessons from the use of results-based approaches in other sectors such as water and sanitation, health, roads, and information and communication technology (ICT). A closing panel of energy practitioners reflected on the reasons behind the slow adoption of these approaches in the energy sector, focusing on key challenges and opportunities in the move towards testing out, and subsequently scaling up, results-based approaches.

The event was primarily attended by World Bank staff but also included a number of external participants, including representatives from ESMAP donor and client countries and civil society organizations. The agenda, and copies of the presentations, are available on the ESMAP website (http://www.esmap.org/esmap/node/1773).

ESMAP
Energy Sector Management Assistance Program

Opening panel—setting the stage

The opening panel highlighted how results-based disbursement of official development assistance from donor to recipient countries can encourage a focus on the achievement of impacts, empowering recipient governments to take their own decisions. This leads to a shift in responsibility and implementation risk from the donor to the recipient and, most importantly, it increases transparency and accountability to their own citizens, encouraging a results culture that better articulates the value-for money of one intervention over another. One specific example presented was Cash on Delivery Aid, an approach proposed by the Center for Global Development and with pilots under implementation or discussion with the UK's Department for International Development (DFID) in the education sector in Ethiopia and Rwanda, and the Clinton Health Access Initiative for malaria control in Zanzibar.

> Results—based approaches have the potential to increase transparency and accountability to citizens in developing countries.

The World Bank recently approved a new lending instrument called Program-for-Results (PforR), which provides a new way to finance client country programs , and complements two existing lending instruments – Investment Loans (for discrete projects) and Development Policy Loans (for policy reform and general budgetary support). PforR allows Bank disbursements to be made against achievement of results rather than against expenditures. Programs can be defined flexibly and may cover a whole sector, a sub-sector or be cross-sectoral. The session acknowledged that PforR provides very good platform to mainstream results-based approaches.

The panel highlighted some of the key features that give flexibility to client countries and task teams when designing a PforR operation. One of the cornerstones will be the definition of adequate disbursement-linked indicators (DLI). In this regard, client commitment to the delivery of results is essential and the definition of such results becomes key from the very early stages of design. However, the focus of the DLIs will depend on the maturity of the target program, with disbursements more closely linked to early action, outputs or outcomes depending on the implementation stage of the particular program. Flexibility is also introduced in the implementation arrangements. Although institutional assessments are still necessary under PforR, the benefitting program, to which the Bank is likely to contribute only part of the financing, will be implemented through the country's own systems. Another relevant feature is that PforR allows for advances of up to 25% for clients with limited resources, thereby addressing the issue of pre-financing, which is often seen as one of the main barriers to the implementation of results-based approaches.

> The definition of adequate disbursed-linked indicators will be one of the key factors in the design of operations under the Program for Results, the new lending instrument recently approved by the World Bank.

The opening panel also heard from the Global Partnership on Output-Based Aid (GPOBA), the 'grandfather' of results-based financing. GPOBA was created in 2003 by DFID and the World Bank with a mandate to fund, design, demonstrate, and document OBA approaches that promote innovative ways of structuring pro-poor subsides to increase access to basic services and improve service delivery. The use of performance-based contracting techniques that transfer risk to (mostly) private service providers in GPOBA's pilots has resulted in the acceleration of investments and creation of markets even in difficult environments, also whilst also allowing for better targeting of the poor. Successful examples include projects in the energy sector, but these have been mostly limited to off-grid systems. The complexities associated with the development of transmission and distribution infrastructure was mentioned as one of the risks that may have so far limited the use of RBF approaches in general, and OBA in particular, in grid-connected programs. It is recognized that OBA is only a subset of the potential array of RBF approaches, meaning there is significant potential to apply a much broader range of RBF instruments in the energy sector to target not only final users directly but also other elements of the supply chain.

Looking at a smaller scale, from an entrepreneur's point of view, results-based financing mechanisms can play a key role, both for off-grid and on-grid investments, in reducing the perceived risks for potential investors. In this sense, the cost of capital could be "bought-down" if the RBF mechanism guaranteed payments per unit of functioning equipment distributed (e.g. for solar lanterns or solar home systems) or per kWh delivered (e.g. for a hydro mini-grid). If appropriately structured, payments against outputs can actually facilitate access to pre-financing, the lack of which is often seen as one of the main barriers to the participation of small private players in a developing country context.

The panel agreed that, to scale-up results-based approaches in the energy sector, there is a need to go to a larger

scale by, for instance, mainstreaming RBF through rural electrification agencies. This might be appropriate when the business environment is such that risk can be adequately addressed. In addition, donors need to move away from a 'hand-holding' mentality and allow recipient governments the flexibility and freedom to test new approaches and take risks in order to achieve results.

> Results-based financing mechanisms can help to "buy down" the cost of capital and facilitate access to pre-financing for small-scale entrepreneurs

Results-based financing should be viewed as complementary to conventional development assistance (such as grants and loans), since there are also a number of limitations, including the need for target beneficiaries to secure pre-financing, higher data collection and auditing costs, and the challenge of accurately setting the incentive to avoid rent-seeking whilst achieving the desired results.

Sector specific sessions

The presentations for the four sectors showcased at the conference can be found on the ESMAP website. Some of the most important lessons highlighted by the speakers are summarized below.

Health sector practitioners insisted that the following aspects be taken into account when considering and designing RBF operations: (i) rewarding results actually yields better results; (ii) robust evaluation is key to determine which RBF approaches actually work; (iii) small-scale pilots (pre-pilots) are helpful to work out technical and programmatic details while larger sized pilots are essential for testing external validity and doing impact evaluations; (iv) real-time learning is both possible and necessary; (v) innovation and creativity should be encouraged.

The roads sector presented some of the main lessons from transforming traditional works contracts into results-based service and management contracts: (i) important to align the motivation and performance of contractors with clients' needs and goals, with contractors becoming real stakeholders; (ii) need to adequately define risks and share them equitably between parties; (iii) great potential for introducing innovation and expertise, and for cost-savings; (iv) need to define mechanisms for non-compliance; (v) guarantees need to be appropriately defined as well as the legal, regulatory and institutional frameworks.

The presentation by the ICT sector highlighted the following: (i) competition for subsidies can dramatically reduce the cost of providing universal service/access; (ii) in countries with a less than liberalized environment, subsidies, if not properly designed, may displace rather than complement private investment; (iii) the introduction of new approaches can pose institutional challenges that delay program implementation; (iv) need to continuously sensitize public partners and relevant stakeholder institutions during the implementation process, including continuous need to share information and lessons on advantages of RBF over other type of contracting mechanisms.

From the water and sanitation sector the key lessons presented were: (i) outputs must be tangible and measurable; (ii) intermediary outputs can address the need for pre-financing; (iii) need for a monitoring method based on the type of output and sound technical baselines; (iv) need to define clear obligations for service providers through contracts; (v) it is key to define clear, measurable, reliable and verifiable baselines, outputs, indicators, technical standards and targets, and sustainability conditions.

Closing panel—results based approaches for the energy Sector

Several challenges and opportunities to scaling-up results-based financing in the energy sector were brought up in the closing panel. Some of the main ones are listed below.

Challenges

Financing: In developing countries, private sector players in the energy sector tend to be small and lack access to debt and equity alike (as opposed to other sectors such as ICT, where private actors usually have much easier access to capital). Most potential participants in a RBF scheme would not be able to do balance-sheet financing either. These are some of the reasons why RBF schemes need to be designed in a flexible way that allows for some type of pre-financing or disbursements against early actions.

Capacity: For access programs, rural electrification funds will need strong capacity building to be able to successfully implement RBF instruments.

Sustainability: It is essential that RBF programs incorporate a sustainable strategy to phase out subsidies. Otherwise, the program could bring the market to a halt (e.g. when subsidies cease but there is a general belief that they will

be reinstituted) instead of incentivizing it.

Scaling up: There is a need to move beyond pilot initiatives towards large-scale projects that generate appetite both within client countries and for time-constrained staff in development institutions. In addition, successful large-scale projects would generate further interest in RBF approaches. However, there is a need to recognize that RBF approaches, by themselves, will not be able to deliver the challenging targets outlined in the Sustainable Energy for All Initiative.

Institutional arrangements: Fostering recipient government ownership will be key for the design and implementation of successful results-based programs. In addition, supervisory responsibilities need to be clearly defined either in the context of existing regulation or under new regulations.

Definition of access: There is also broad consensus on the need to define what we mean by 'energy access' to be able to appropriately define and measure outputs and outcomes as well as to segment the market appropriately and identify commercially viable business models.

Opportunities

Innovation: Results-based instruments open the door for innovative approaches, either in the form of new business models, smarter financing structures, remote monitoring and verification, and support to feed-in tariffs when the government has shown long-term commitment to a specific technology, etc. Innovative approaches also have the potential to unlock already available concessional resources.

Program for Results: The presentations from the different sectors showed that, even before the existence of the P4R instrument, it was possible to design results-based operations, usually under the framework of an Investment Loan, at a reasonable cost and with a reasonable preparation time. It is expected that the new instrument will provide a clearer framework that will encourage more client countries and Bank practitioners to design results-based operations when appropriate.

Climate Investment Funds: In the context of the CIFs, there is strong interest from a number of donor countries in moving towards results-based instruments. Although caution should be exercised against over-focusing on those approaches, there are some clear opportunities, especially under the Scaling-up Renewable Energy Program (SREP), which supports renewable energy in low income countries. In several cases, RBF has the potential to incentivize speed, private sector engagement, mobilization of capital and a stronger focus on results. The Clean Technology Fund (CTF) also offers opportunities, with the India super-efficient equipment program as an example in which subsidies are provided directly to manufacturers who produce more efficient appliances.

Energy efficiency: If indicators are defined correctly, incentives for energy efficiency and loss reduction programs could be designed and introduced.

The Energy Sector Management Assistance Program (ESMAP) is a global knowledge and technical assistance program administered by the World Bank. It provides analytical and advisory services to low- and middle-income countries to increase their know-how and institutional capacity to achieve environmentally sustainable energy solutions for poverty reduction and economic growth. ESMAP is funded by Australia, Austria, Denmark, Finland, France, Germany, Iceland, Lithuania, the Netherlands, Norway, Sweden, and the United Kingdom, as well as the World Bank.