

Water in the Arab World:

MANAGEMENT PERSPECTIVES
AND INNOVATIONS

N. Vijay Jagannathan
Ahmed Shawky Mohamed
Alexander Kremer

Editors



MIDDLE EAST AND NORTH AFRICA REGION
THE WORLD BANK



Subsidies for the Poor: An Innovative Output-Based Aid Approach

Providing Basic Services to Poor Periurban Neighborhoods in Morocco

Xavier Chauvot de Beauchêne and Pier Mantovani

What Is Output-Based Aid?

Output-based aid (OBA) is an innovative approach to increase access to basic services for the poor in developing countries and to improve the delivery of services that exhibit positive externalities, such as reductions in CO₂ and improvements in health.¹ OBA is also known as “performance-based aid” or (in the health sector) “results-based financing.” OBA is part of a broader effort to ensure aid effectiveness.

OBA links the payment of aid to the delivery of specific services, or “outputs” (box 17.1). These can include the connection of poor households to electricity grids or water and sanitation systems, the installation of solar heating systems, or the delivery of basic healthcare services. Under an OBA scheme, service delivery is contracted out to a third party—usually a private service provider but, in some cases, community or nongovernmental organizations or public sector utilities. The third party receives a subsidy to complement or replace connection fees for poor households (HH) that cannot afford to pay the full connection fee. The service provider is responsible for “pre-financing” the project until output delivery, when it receives reimbursement through an OBA subsidy. The subsidy is performance based, meaning that most of it is paid only after the services or outputs have been delivered and delivery verified by an independent agent.

¹ For more information, visit Global Partnership on Output-Based AID’s (GPOBA) website, www.gpoba.org

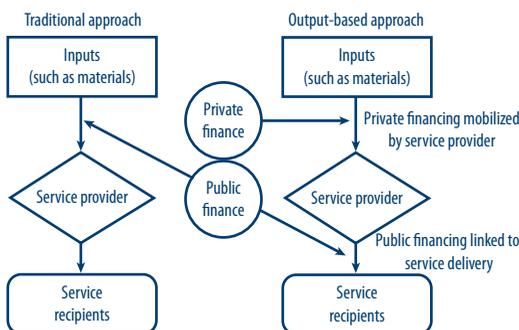
Box 17.1 Output-Based Aid: Core Concepts

- **Increased transparency through the explicit targeting of subsidies** and tying these subsidies to defined outputs
- **Increased accountability through shifting performance risk to service providers** by paying them after they have delivered an agreed output
- **Increased engagement of private sector capital and expertise** by encouraging the private sector to serve customers, usually the poor, whom they might otherwise disregard
- **Encouraging innovation and efficiency** by leaving the service “solutions” partly up to the service provider
- **Increased sustainability of public funding** through the use of one-off subsidies and by linking ongoing subsidies to sustainable service
- **Enhancing monitoring of results** since payments are made against agreed outputs

OBA schemes contrast with traditional aid approaches, which usually focus on financing “inputs” such as infrastructure (for example, a water treatment plant or a hospital) or equipment (such as books for schools) (figure 17.1). Under the OBA approach, the priority shifts from making a service generally available to ensuring that the poorest households actually benefit from the service. For instance, a traditional electricity project might finance the expansion of the electricity grid to poor areas. In contrast, an OBA project would subsidize the cost of connecting households in the poor areas to the grid, or it could subsidize off-grid solutions such as solar home systems for communities in remote areas. OBA schemes thus can complement traditional aid

and make service delivery more inclusive.

Figure 17.1 Input-Based Approach vs. Output-Based Approach



Source: Author.

Note: Scale = 1: 70,000

Why Is OBA Relevant for Morocco?

By regional standards, Morocco already has good water infrastructure assets. Ninety percent of accessible resources are stored in 116 large dams; irrigation is developed over 1.4 million hectares

(ha); and potable water supply reaches almost all urban dwellers. In fact, with individual connections and continuous service for 83 percent of households, Morocco has one of the best potable water supply rates in the region. However, infrastructure is lagging for rural water supply (70 percent in 2007), urban sewerage (70 percent of households connected as of 2005), and wastewater treatment (5 percent of discharges treated in 2004). Access to service remains particularly inadequate in poor urban and periurban areas.

Today, the country faces two challenges. First, it must adapt water usage to levels compatible with the renewable resources supplied by nature. Second, Morocco has to improve service access and efficiency while reducing the burden on the state and on poor consumers. Reforms have been initiated to address these challenges, including through policy and expenditure reorientation.

The government developed a comprehensive reform program that focused on the integrated and sustainable management of water resources. This program included the National Initiative for Human Development (INDH), launched by the King in May 2005. This initiative included a significant component to expand basic services to the poor, particularly those in urban and periurban settlements previously considered illegal and, therefore, ineligible for services.

Pilot OBA schemes were set up to encourage water utilities to improve access in low-income communities. The next sections review the design and results of these pilot interventions.

Nature of Service Deficit in Periurban Areas of Morocco

Currently, approximately 2 million Moroccans remain without access to water supply and sanitation services (WSS) in illegal settlements surrounding the country's major cities.² In the Casablanca metropolitan area alone, approximately 145,000 households (or 900,000 inhabitants) are estimated not to receive adequate water supply and sanitation services. These residents who lack access to reliable and clean water supply services get water from (1) contaminated shallow wells; (2) water providers selling nonpotable water at a relatively high unit price;

² In this context, "periurban" includes all settlements located at the outskirts of a city and structures in city quarters or hamlets, illegal or not; and encompasses hamlets presenting characteristics of rural areas but not belonging to rural communes (municipalities).

or (3) standposts located at the entrance of these areas, which often require women or children to stand for several hours in a queue.

Access to basic sanitation is even more deficient. A majority of households use cesspits and poorly designed septic tanks. These rudimentary accommodations risk increasing the contamination of shallow groundwater. A large number of inhabitants of the poorest areas remain without any form of sanitation.

The situation described above directly affects people's health, their ability to engage in income-generating activities, and, for children, to attend school. It also harms the water utilities' finances, as cost recovery from these public standposts is usually very low. The municipalities (communes) responsible rarely pay the bills.

Four factors have contributed to the lack of WSS for Morocco's poor:

- Unplanned growth of periurban areas and the fact that they were systematically not included in the service areas of water and sanitation operators.
- Technical and administrative hurdles that made interventions by operators in illegal settlements difficult, linked to, for instance, lack of title, poverty, and lack of basic access infrastructure.
- Operators' difficulty in financing infrastructure for water users eligible for the loss-making "social tranche" of existing water tariffs.
- Connection fees charged to the beneficiaries at their marginal costs, to which a *Participation au Premier Etablissement (PPE)* fee is added. The latter drives up costs of access to unaffordable levels for most HH living in the city outskirts, even when the option of payment by installments is available through the "Social Connection" program.³

Mobilization through the National Initiative for Human Development (INDH)

Since 2005, the National Initiative for Human Development (*Initiative Nationale de Développement Humain*, or INDH) and the Government's

³ "Social Connection" programs offer to pay HH for the full connection cost in installments over time. However, the program requires that, to access these basic services, households get into debt for durations of 7 to 10 years. This outcome appears neither plausible nor equitable.

Cities Without Slums program (*Ville Sans Bidonville*, or VSB) have mobilized stakeholders to upgrade poor urban and periurban areas.

INDH/VSB programs removed the most important obstacle by recognizing informal areas, and promoting their inhabitants' resettlement to housing units in apartment buildings (*relogement*), their resettlement in fully or partially serviced plots (*recasement*), or "restructuring with on-site upgrading" through the expansion and strengthening of basic infrastructure. INDH also promotes service coverage expansion by promoting agreements among relevant stakeholders. The specific arrangements developed through INDH regarding the financial contribution of households⁴ for a house connection to water and/or sanitation services⁵ are of paramount importance in reaching coverage objectives.

Although significant, the activities above only partly address the INDH's water and sanitation access objectives for 2010:

- a. Due to lack of financing, connection development is inadequate for on-site upgrading areas. For example, in the metropolitan Casablanca area, INDH is considering expanding WSS only to the 65,000 households to be resettled either in housing units or in serviced plots. That leaves a population of approximately 80,000 households, representing over 500,000 inhabitants, targeted by the on-site upgrading approach for whom no service expansion solution is proposed.
- b. Implementation of INDH/VSB programs is not always optimal. For example, problems linked to coordination and implementation of network expansion works often prevent house connections from being established.

INDH's Urban Water Supply and Sanitation OBA Pilots

The objectives of the project pilots are to demonstrate replicable OBA mechanisms to extend WSS services in poor and vulnerable communities, as part of the INDH.

⁴ Households are offered the opportunity to pay their connection fees over time, the terms varying by operator. For instance, in Meknes, the household contribution has to remain below MAD 9,240 for connections to WSS services, reimbursable in 84 monthly payments of MAD 110.

⁵ Waiver of an important "First Settlement Fee-*Participation au Premier Etablissement* (PPE)" and of the 10% design and supervision fee otherwise charged by the operators.

Started in the spring of 2007, Morocco's Urban WS&S OBA pilots aim at connecting 11,300 households to piped WSS in poor, unzoned, periurban neighborhoods of 3 municipalities: Casablanca, Meknes, and Tangiers. The pilots are funded through a US\$7 million grant by the Global Partnership for Output-Based Aid (GPOBA). They are implemented by the respective service providers in these municipalities: 2 international private concessionaires, namely, Amendis in Tangiers and LYDEC in Casablanca; and 1 municipal utility, the Régie Autonome de Distribution d'Eau et d'Électricité de Meknès. The Government of Morocco is also a partner to this approach, playing an oversight and monitoring role.

While the details of the schemes vary, the common objective of the pilots is to test an OBA subsidy mechanism specifically targeted toward poor neighborhoods and households; and bridging the gap between capacity to pay and a competitive cost of connection. In addition to the waiver, for areas identified as part of the INDH program, the scheme offers a subsidized connection fee for some of the fees otherwise charged by the operator.

The approach builds on previous "social connection" programs by which households were offered the opportunity to pay their connection fees in installments.

Awarded to individual eligible households who agree to pay the operator-specific beneficiary contribution, the subsidies are pre-financed by the operators, who first are required to complete the pipe and connection works. They get reimbursed after a verification process that certifies that the eligible household is in fact receiving piped WSS service (that is, the output).

The built-in incentives of this OBA approach are designed to mitigate traditional impediments of service expansion programs in marginal neighborhoods. Impediments include (1) unaffordability of connection costs by households, (2) unsustainable program financing for operators, (3) complex technical and administrative obstacles to infrastructure development in poor unzoned areas, and (4) reticence by national and local governments to fund subsidy programs that have no accountability or guarantee of results.

The outputs for which OBA subsidies are disbursed are individual HH network connections for simultaneous water supply and sewerage services in designated, predominantly poor periurban neighborhoods. These HH have the recognized right to access services through the INDH program. In Meknes, the output is the connection to either service.

The disbursement profile of the individual subsidy follows: (1) 60 percent of unit subsidy is released upon verification of eligible water and sewerage household connection, and (2) 40 percent of unit subsidy is released upon verification of sustained service for at least 6 months.

Subsidy Targeting Is Geographic in Nature

The target neighborhoods are recognized as being among the poorest in urban Morocco, and are on the INDH's shortlist of 160 most disadvantaged urban and periurban communities. All households in the selected pilot areas are eligible to participate in the connection subsidy program. However, participation is strictly demand driven. It therefore requires communication campaigns to raise awareness about the program and explain its conditions. Operators also develop new means of reaching potential customers. They use dedicated teams who go to market places or to the heart of the targeted neighborhood to record the demands of beneficiaries who may not easily travel to one of the operator's agencies.

Scope and size aside, the project breaks new ground in many regards. It is the first

- OBA project in Morocco
- Project involving multiple incumbent operators
- Project involving a public operator
- World-Bank-implemented OBA involving connection to sanitation
- World-Bank-implemented OBA project in local currency.

Lessons Learned So Far

A key element of the approach is to shift risks to incentivize all parties to perform. In this case, the financial and operational risk in extending service requires a good assessment of the demand for services by the targeted population, as demand will determine the amount of subsidy the operator will receive.

Another key element is the limitation of the risk of capture of outputs. As in former social connection programs, an authorization to connect from the municipality is required. Therefore, there is a risk that political pressure could be put on the operator to extend subsidized connections to populations who may otherwise have the means to

pay the full cost of connection. The pilot is organized on a geographic basis, for lack of a better targeting mechanism. However, it targets poor neighborhoods that had been without piped services up to that point. Socioeconomic surveys carried out show that a significant share of the population living in these informal areas are below the poverty or vulnerability lines for Morocco.

Nevertheless, to avoid the risk that the relatively wealthier households could benefit from the subsidy, the operator and local authorities (province, governor) have developed additional eligibility criteria, for example, based on the number of stories or house size and appearance. Moreover, to increase transparency, the operator has requested that the list of beneficiaries be signed by the municipality and countersigned by the governor (local representative of the state).

Although a substantial number of outputs have been delivered and verified in all three sites, the pilots experienced a slow start. The first 12 months of the pilot program have produced approximately only 2,000 connections, that is, 15 percent of the program's 3-year objective. However, an independent midterm review of the pilots shows that the delay is due to implementation difficulties unrelated to the OBA approach: procurement procedures, upstream investment delays, and lack of clarity over land tenure. The parties appreciate that conventional financing would have resulted in fewer connections than OBA in the same circumstances. Thus, scaling up the OBA approach to other INDH areas now is considered possible before pilot program completion in December 2009.

The midterm review confirmed important direct benefits⁶ to households, and recorded the high satisfaction of beneficiary households with the service provided. This information is further demonstrated by evidence of uptake significantly increasing after works start and a collection rate equal or superior to the average experienced by each operator in his/her service area.

Operators and government generally are satisfied and appreciate the flexibility allowed by the pilot. The OBA approach is seen as helping to improve processes, overcome financing blockages, and mobilize stakeholder partnerships. In addition, all parties appreciate that quarterly inspections by the Technical Independent Reviewer have proven

⁶ Essentially, benefits are time savings but also can include reduced health costs and improved hygiene practices. Further study would be necessary to quantify such benefits.

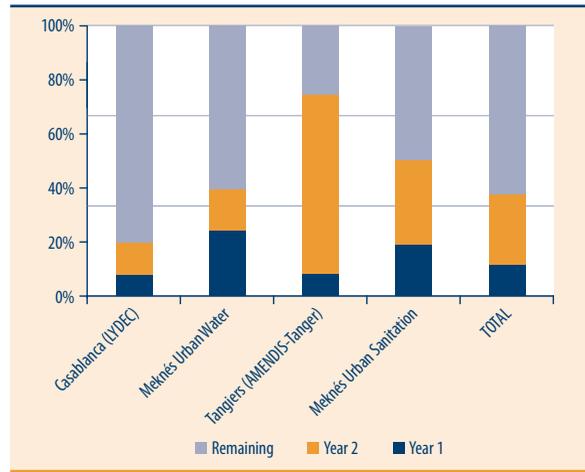
effective in firming up the operators' reporting requirements as well as improving their implementation methods. The demand-driven approach contributed to refocus service provision around the households, which increased accountability, strengthened partnerships between local authorities and operators, and prioritized monitoring of service delivery.

After a slow year 1, a doubling of connection rates is reported in year 2. Figure 17.2 shows connection realizations during the first two years of implementation.

Lessons learned for the potential scale-up of the pilots include the need for:

- a. Better advance planning and working partnerships among operators, local governments, and neighborhood associations to clarify eligibility and permitting questions
- b. Streamlining OBA-specific ex-post eligibility verification procedures.

Figure 17.2 Connections Realized in the First Two Years of Implementation



Note: Figure 17.2 reflects progress on the defined "outputs" under the project, namely, the working connections to water and/or sanitation services. The figure does not reflect the progress achieved on the upstream/trunk infrastructure development necessary to deliver the outputs. Therefore, it may not accurately reflect the progress under the pilots.

Scaling up OBA: Toward a National Strategy to Reduce Urban and Periurban Service Access Deficit

Given the lack of targeted subsidy mechanisms for poor households, especially in informal urban settings, OBA is perceived as strategically relevant to Morocco. The OBA pilots are taking place at a time that the government of Morocco is seeking new ways to deliver on INDH's promise. The government has expressed interest in replicating, with due adaptation, the OBA approach on a citywide or nationwide scale. The Bank is working with the government on the best ways to evolve toward a scaled-up operation, while strengthening coordination among institutions in charge of the different aspects of periurban utility service.