



Handbook

Contracting out government functions and services in post-conflict and fragile situations

Organisation for Economic Co-Operation and Development

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Foreword

The ability to deliver essential public services and government functions is a prerequisite for the legitimacy of states. The foundation of a resilient state — the social contract between citizens and their government — is imperilled when the basic needs of its people are not met.

The Partnership for Democratic Governance (PDG) was created in 2007 to address this issue by gathering evidence on innovative approaches to support fragile states, including through the contracting out of essential services and core government functions. A key driver behind the PDG's inception was the wish to explore innovative approaches to strengthen the capacities of fragile states in line with the aid effectiveness agenda as embodied in the Paris Declaration and the Accra Agenda for Action.

It is within this context that the PDG developed this *Handbook on Contracting Out Government Functions and Services in Post-Conflict and Fragile Situations*. The culmination of a three-year consultative process, this handbook represents a one-of-a-kind operational resource for field practitioners and government policy makers to guide them in making better-informed decisions about the nature of contracting out, and to assess

❖ Contracting out also enables developing countries to assert their sovereignty by setting policy and regulating the services or functions being contracted out, including during the critical phases when peace is being consolidated.

the options available to them when deciding whether to externalise certain services. This handbook, which was developed in collaboration with field practitioners from developing and developed countries, experts and donors, does not advocate a “contracting out model” in fragile states, but, rather, provides guidance that is adaptable to various situations and stresses the importance of longer-term sectoral and capacity development strategies. A useful starting point before taking any decision to contract out, this handbook also illustrates its main points with the aid of case studies taken from a number of fragile states, ranging from Afghanistan to Haiti and Liberia.

The Handbook shows that in post-conflict and fragile situations, the use of external providers has allowed developing and developed countries alike to provide essential services such as clean water, and core functions ranging from customs services to domestic resource mobilisation. However, in countries with limited capacity and where sovereignty is still in the making, the use of external providers who are contracted to handle a service or function fully or partially has been viewed as controversial and the subject of much debate. When not done properly, contracting out risks bypassing or substituting the state, and can undermine the development of its capacity to manage and deliver these services or functions. However, contracting out also enables developing countries to assert their sovereignty by setting policy and regulating the services or functions being contracted out, including during the critical phases when peace is being consolidated.

We hope that this handbook will prove to be a useful compass for both field practitioners and policy makers alike.



Angel Gurría
OECD Secretary-General

Acknowledgements

This handbook emerged from the diagnosis that states in situations of fragility can contract out their core government functions or services such as customs, audit, health, education or sanitation while retaining stewardship, developing their capacity to set policy and regulate these services, and even regain partial or total control over time should they decide to do so. This publication is the result of a collaborative effort by member countries and organisations of the OECD Partnership for Democratic Governance (PDG) and has benefited from the contributions and insights of a wide range of experts and colleagues from various development, academic and legal communities.

The PDG will continue to expand on the tools contained in this handbook based on the knowledge gained from its advisory practice. Future topics for similar handbooks will also emerge from the PDG's work in fragile situations, for example on the use of returning diaspora, public-private partnerships, or on more overarching issues such as methods of capacity building for core government functions. These handbooks will aim to provide operational guidance for use by policy makers, practitioners and a range of stakeholders, with relevant analysis on the types of contexts, sectors or variables that must be in place for the effective use of different tools and modalities for service delivery.

The concept of this handbook was developed by Bathylle Missika (OECD/PDG) and Corrado Scognamiglio (OECD/PDG) under the supervision of Jerzy Pomianowski (OECD/PDG). The process of preparing the handbook was managed by Bathylle Missika and Richard Batley (University of Birmingham).

The co-ordinating editor was James Eberlein (OECD/PDG). Members of the core drafting team for the final version of the handbook included Richard Bontjer (consultant), Derick Brinkerhoff (RTI International), Fiona Davies (United Nations Development Programme – UNDP), Gregory Ellis (World Bank), Joe Lowther (Cardno Emerging Markets Group), Claire McLoughlin (University of Birmingham) and Arthur Smith (consultant).

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The scope, structure and key elements of the handbook were discussed by members of the independent PDG Experts' Group during a preparatory meeting at OECD Headquarters in October 2009. On that occasion, contributions were provided by Wendy Abramson, Fiona Davies, Elaine Grigsby (USAID), Joe Lowther and Arthur Smith. Invaluable feedback was also provided by the meeting participants, including Karen D'Aboville (USAID), Bernard Becq (World Bank), Michael Carnahan (Australia National University), Bruce Coyne (Cardno), Kami Dar (Devex), Gregory Ellis, Yukimasa Fukuda (Institute for International Monetary Affairs), Gareth Rannamets (Crown Agents) and James Wahome (African Development Bank).

The design and layout of this handbook was developed by Frédérique Duboscq.

The OECD Partnership for Democratic Governance (PDG)

The ability to deliver essential public services and government functions is a prerequisite for well-functioning, legitimate states. It is also a necessity if states are to meet the most basic needs of their citizens while maintaining security and stability, bringing in foreign direct investment, pursuing poverty reduction objectives and strengthening governance.

In order to take a more strategic approach to this key development challenge, several members of the Organisation for Economic Co-operation and Development (OECD), together with the United Nations Development Programme (UNDP) and a group of middle-income countries, launched the Partnership for Democratic Governance (PDG) in 2007. It is housed by the OECD and supported by UNDP.

The members of the Partnership for Democratic Governance are Australia, Canada, Chile, Denmark, Japan, Korea, Mexico, Poland, Turkey, the United States, the African Development Bank, the Inter-American Development Bank, the Organization of American States, the OECD and UNDP. Brazil, Italy, New Zealand and the United Kingdom participate in the PDG as observers.

See further: www.oecd.org/pdg

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Acronyms and abbreviations

AAA

Accra Agenda for Action

ADB

Asian Development Bank

ADB I

Asian Development Bank Institute

AfDB

African Development Bank

AVRL

Aqua Vitens Rand, Ltd. (Ghana)

BDMP

Business Management Development Programme (Angola)

BOT

Build-operate-transfer (contract)

BPHS

Basic package of health services

CBO

Community-based organisation

CCSS

Costa Rican Social Security Fund

CEMP

Customs Expansion and the Modernisation Programme (Angola)

DAC

Development Assistance Committee (OECD)

DFID

Department for International Development (UK)

FBO

Faith-based organisation

FMC

Forest management contracts

GPOBA

Global Partnership on Output-Based Aid

GWCL

Ghana Water Company, Ltd.

ICC-ICA

International Chamber of Commerce – International Court of Arbitration

IDA

International Development Association (World Bank)

INCAF

International Network on Conflict and Fragility (OECD-DAC)

INGO

International non-governmental organisation

MDTF

Multi-donor trust fund

MIGA

Multilateral Investment Guarantee Agency (World Bank)

MOU

Memorandum of understanding

NDC

National Directorate of Customs (Angola)

NGO

Non-governmental organisation

NRA

National Revenue Authority (Sierra Leone)

NSP

Non-state provider

OBA

Output-based aid

OECD

Organisation for Economic Co-operation and Development

ORT

Oral rehydration therapy

PDG

Partnership for Democratic Governance (OECD)

P4P

Pay for performance

PPP

Public-private partnership

PSI

Population Services International

RBF

Results-based financing

RFP

Request for proposal

RFT

Request for tender

SADC

Southern African Development Community

TSC

Timber sales contracts

UNCITRAL

United Nations Commission on International Trade Law

UNDP

United Nations Development Programme

UNECA

United Nations Economic Commission for Africa

UNICEF

United Nations Children's Fund

USAID

United States Agency for International Development

VAT

Value added tax

WHO

World Health Organization

Executive summary

What is this handbook for?

The contracting out of government functions and services to external providers is an established practice in many developed and developing countries. However, in countries that are recovering from conflict or where governments are especially weak (referred to here as “fragile states”), the use of contracting out is controversial and the subject of some debate. On the one hand, it can offer essential support to states that have to deliver basic services urgently; on the other, it risks bypassing governments and undermining their long-term recovery. The OECD’s Partnership for Democratic Governance was formed in 2007 to gather evidence on this issue. This handbook is one result.

Contracting out is when a purchaser (the state) pays a third party (non-state organisation) to perform a task set out in a formal agreement (the contract), which is enforceable by law.

The handbook does not take a view for or against contracting out; nor is it a technical manual. It is designed to help policy makers and practitioners who have to decide whether and how to contract out. Its five chapters take the reader step-by-step through the following processes:

1. Identifying the available contractual options and considering their application to government functions and services, especially in fragile states.

2. Understanding the incentives working either for or against contracting of the various relevant actors (government, donors, service providers and end users); understanding the political and technical risks that may undermine the process; and understanding how these may be reduced.

3. Assessing the capacity available for contracting out successfully. This includes the capacity within the wider policy environment and the organisational environment, and at the individual level. Once capacity has been assessed, the handbook suggests ways for strengthening weak capacity through the contracting-out process.

4. Procuring contractors’ services: deciding the expectations of contracting, the strategy for procuring the services needed, the form of contract to be used, the tendering process, and how to monitor performance.

5. Implementing the legal aspects of contracting out of government functions and services, including the structuring, negotiation, design and drafting of contracts, enforcing contract stipulations and resolving disputes.

The handbook illustrates these points with the aid of case studies from many different fragile states, ranging from Afghanistan to Haiti and Liberia.

The scope of contracting out in fragile states

Governments in fragile states need to maintain legitimacy, ensure security and deliver services to their people, often in situations where significant portions of the population are displaced, physical infrastructure is significantly impaired, the rule of law is minimal or absent, the private sector is highly informal, and basic services – if they exist – are delivered mainly by non-governmental and civil society organisations. Moreover, the government itself is likely to be facing significant operating constraints: legal revenue collections may well be minimal, and government institutions may lack appropriately qualified staff. In such circumstances, contracting out may be the only feasible option for addressing the government's immediate delivery challenge.

At the same time, governments with weak capacity to deliver services may also be unable to manage the contracting-out process. There may also be concerns that contracting out essential functions and services will prevent the government from developing its own capacity for doing so. However, there is no reason why contracting should undermine the long-term development of state capacity so long as the state retains a role in awarding and monitoring contracts, setting policy frameworks and service standards. The arguments for and against contracting out are presented in the table below.

Positive and negative perceptions about contracting out in fragile states

Positive	Negative
<ul style="list-style-type: none"> • Can allow a greater focus on measurable results, accountability and reduces misuse of funds • Can increase effectiveness and efficiency through competition • Can allow governments whose capacity is limited to pass on the delivery role and to focus on roles such as planning, standard setting, financing and regulation • Can allow for rapid expansion of services by bringing in specialist providers • If successful, can slowly mend or rebuild the social contract between citizens and the state • Can allow for the co-ordination of multiple public and private providers 	<ul style="list-style-type: none"> • Can reduce competition among providers • Can involve transaction costs, which may cancel out any efficiency gains • Can increase risk that governments with weak capacity to deliver services and with weak stewardship roles can lose control altogether, <i>i.e.</i> sovereignty can be reduced • Can increase opportunities for corruption • May be perceived as undermining direct provision by government

Understanding the political and technical influences on contracting out

Contracting out does not take place in a vacuum and can be highly politicised. Political and technical risks may affect the feasibility of contracting out. The challenge for government – and, to an extent, donors – is to assess key stakeholders' incentives before deciding whether or not to contract out. This assessment should evaluate what is at stake for each of them. Who stands to benefit from the decision to contract out? Who are the potential losers? Will the losers become a significant obstacle to the success of the process? What is their capacity to undermine the process?

- Governments may wish to use contracting to improve service provision, to overcome rigidities in the public sector or to strengthen public administration. On the other hand, they may be concerned that contracting out signals a loss of governmental authority or even sovereignty, especially in situations of political instability. They may also distrust contractors.
- Donors may see government contracting as an opportunity to improve service provision and increase government ownership. On the other hand, they may have financial concerns about ceding control of contracting to governments.
- Non-state service providers will balance opportunities for scaled-up operations and more predictable contracts against concerns about acting as a government agent.

- Service users may look forward to improved services, but be worried that contracting out may bring with it user charges, create new opportunities for corruption and generate uneven service quality.
- Broader civil society may view contracting with scepticism and consider it a sign of weak government if public information is not handled properly.

Contracting out is vulnerable to **political risks** when the incentives for contracting out have not been adequately assessed, and a decision to contract out is taken without sufficient support or understanding amongst the key actors. These risks can be reduced: for example, by maintaining a dialogue between key actors, adjusting the design of contracts to address their needs and concerns, and undertaking pilot projects to demonstrate the feasibility of contracting out.

Contracting out is also vulnerable to **technical risks**, such as gaps in the capacities, systems, information and markets required for contracting out. These can be reduced by developing government systems for contracting out, ensuring appropriate contract selection and design, and providing technical support to government.

Contracting out and capacity development

Contracting out is a complex undertaking which requires strong capacity – within both government and the non-state sector – in order to be successful. The first step for anyone deciding whether or not to contract is to assess this capacity in three areas:

1. individual human skills and resources;
2. organisational structures and processes; and
3. the enabling environment of policy, laws and rules.

Contracting out is not a replacement for internal and country-led capacity development. Failure to develop government capacity for delivering services, whether overseeing delivery or providing them directly, may eventually undermine the legitimacy of the state in the eyes of its population and its accountability towards its citizens.

What should be done if this evaluation reveals that the state has insufficient capacity to contract out in all three of these areas? If capacity is weak at all levels, the government should bring in a procurement agent to act on its behalf to manage the acquisition of services and products until government capacity has improved, as was done in **Afghanistan** and **Liberia**. However, using a procurement agent can be risky: for example, the agent may act as though it were immune from political and judicial oversight, or conflicts of interest may arise if the agent becomes very closely involved in shaping contracts and then participates in procurements. The government will need new legislation or other

tools to establish a solid basis for government procurement and to closely monitor the agent's performance – this again raises questions of capacity, but technical assistance can be of help.

While the use of a procurement agent can fill the immediate capacity gaps facing a country, the state needs a strategy to manage the transition from dependence on external resources to long-term sustainability. This transition is vital to the post-conflict restoration of service delivery, and it also enhances state building and reduces fragility.

Contracting out can be used as a tool both to provide services and to develop the necessary capacities for contracting out. These functions can be contracted for separately, or capacity development can be built into the same contracts that provide for short to medium-term service delivery. The contract should require the contractor to help develop the capacity of certain government institutions and/or employees. Such an approach has been taken for customs development in **Mozambique** and for **Sierra Leone's** National Revenue Authority.

Capacity development is a continuous process, which is best achieved by introducing actions gradually across a number of areas: recruitment of staff, provision of technical assistance, the progressive assumption of roles by government, and the assessment of progress against benchmarks. There are no quick fixes, particularly in a fragile state.

Contracting out in practice

Once the decision is taken to contract out a government service or function, procuring these services involves four steps:

1. Defining and initiating the contract: this involves answering the following questions: What is needed, who requires it and can it be clearly defined? What outcomes do we want, are they realistic and how can we achieve them? When, where, how often, and for how long are these services required? Is the need urgent and how quickly can it be met? A needs assessment involving all stakeholders is the best way to answer these questions. Defining needs as measurable outputs allows the contract payments to be tied to achieving specific objectives or performance levels. This performance or output-based contracting provides incentives for the contractor to deliver the services required. Other aspects to be decided are the availability of funding, the type of capacity to be built, and whether the contract will go to a single provider or whether competitive bids will be sought.

Needs should ideally be defined as desired outcomes or impacts (*e.g.* a reduction in waterborne diseases), but in fragile states it is much more likely that they will be defined as outputs (x number of houses connected to water supply). This is because it is much more difficult to assess the effect of a specific contract on general outcomes.

2. Planning the procurement: The procurement plan details the procurement process, the sequence of actions required, the responsible parties, and the schedule. This plan is an important management tool which helps guide the partner government and improves the probability that the desired results will be obtained.

3. The tendering process and choosing the contractor: Through the tendering process a request for tender (RFT) is prepared and issued, the evaluation process is established, tenders are evaluated, and the contract is awarded. The government should provide clear guidance to potential contractors in order to achieve its goals and objectives. The procurement should also be performed in an open and transparent manner, since this will minimise the potential for corruption, and help the partner government achieve the most competitive price for the contracted services or functions.

4. Finalising and monitoring the contract: The fourth and final step is the post-award stage, where contract monitoring, implementation and evaluation occur. This includes deciding whether government will reassume responsibility for the services at the end of the contract, or if it will continue to contract them out (while remaining engaged through monitoring and evaluation, etc.).

This handbook covers three broad **categories of contract:** management contracts, service contracts and works/supplies contracts.

Implementing the legal aspects of contracting out in fragile states

Legal issues need to be considered early on and throughout the entire contracting-out process. Ideally, a country will have a legal framework comprised of a number of laws that enable contractors to provide government services. However, fragile states may lack the institutions, systems, personnel and legal framework necessary to develop, negotiate and oversee contracts. If a fragile state has a poor legal environment, it will be an important priority for the government to take steps to strengthen it (as occurred in **Afghanistan**). In the meantime, a poor legal environment can be compensated for through a number of means: the contract itself can include requirements that would normally be found in laws; laws of other countries can be used; and deficiencies in administrative structure and regulatory capacity can be provided by contracting out administration and regulation.

A contract should set out the parties' rights and responsibilities and should prevent unnecessary disputes by having the parties consider all issues in their intended relationship. It must contain certain elements that ensure it is binding (creating a legal obligation) and enforceable (in court or arbitration). The government should consider early on whether it needs a formal and detailed contract or something less formal and complete. In fragile situations where information, the legal framework and the capacity to develop an elaborate contract are weak, parties may enter into an informal non-contractual agreement. This is essentially a non-written public-private partnership in which both parties have similar goals. In fragile states in crisis, where needs cannot be easily

known or prioritised, governments may also need to have an incomplete contract which allows for changing the terms as needed.

In **drafting the contract** the terms must be specific with little room for interpretation, since each term gives rise to a contractual obligation. The terms include the scope and price of work, payment arrangements, duration of the contract, arrangements for its termination, monitoring and dispute resolution.

In many cases, **guarantees** or bonds will be needed to secure performance and to enable financing for the contractor. Performance bonds or guarantees are pledges by banks or other third parties to compensate the government if the contractor fails to deliver on a contract. Loan guarantees and loans secured by collateral are other means for contractors to obtain the financing necessary to provide services. When it has sufficient capital, the government can provide a degree of financing through on-lending (making capital available to banks to lend funds to contractors, and advance payments by the government). This could be necessary to help small domestic firms and NGOs to finance the provision of services.

A performance bond can protect the government from the risk of a contractor failing to perform, and can help reduce patronage and corruption, as was discovered in the forestry sector in **Liberia**.

The contract should be clear about what outputs are expected and the key indicators that will be used to **monitor the contract**. It should set out the actions that will be taken if the level of service does not match these indicators. The contract should incorporate provisions for **enforcement**. It should state the contractual terms specifically so that it is clear when a breach of contract has occurred, and should also set out the procedures for dispute resolution and arbitration, and obtaining and enforcing judgements.

Afghanistan's Ministry of Public Health contracted NGOs to provide a basic package of health services. The ministry developed a balanced scorecard to regularly monitor the progress of the contractors against six domains (patient perspectives, staff perspectives, capacity for service provision, service provision, financial systems, and overall vision). For these domains 29 indicators and benchmarks were then developed.

Introduction

How did this handbook come about?

The OECD's Partnership for Democratic Governance (PDG) was set up in October 2007 to examine how the international community could best help fragile states or those recovering from conflict (see Box 0.1) to strengthen their core policy functions (including through contracting them out). The initiative brought together a group of like-minded countries and international organisations at a time when several organisations, such as the World Bank and the Asian Development Bank, were also reflecting on different approaches for allowing these states to operate successfully and to address the basic needs of their citizens.¹

In June 2009, the PDG and the African Development Bank (AfDB) co-hosted a conference on “Contract-

ing Out Core Government Functions and Services in Post-Conflict and Fragile Situations”.² The objective of the conference was to examine how contracting out government functions and services in fragile states could be compatible with the long-term goals of capacity development and state building. The conference gathered 80 participants from a wide range of development aid stakeholders: OECD members (Canada, Chile, Japan, Poland, Turkey, the United Kingdom, the United States and the European Commission), non-OECD donors (Brazil), international organisations (Asian Development Bank, United Nations Development Programme, United Nations Economic Commission for Africa and United Nations Children's Fund), NGOs and the private sector. Fifteen partner countries from Africa

Box 0.1 What do we mean by fragile states?

The donor community is still debating how to define “fragility”. There are numerous typologies, as well as many quantitative indices that measure different features of fragility. The OECD's Development Assistance Committee (DAC) defines a fragile state as one which is unable to “meet its population's expectations or manage changes in expectation and capacity through the political process” (Jones *et al.*, 2008).

There is no fixed list of countries which are in situations of fragility and this handbook does not aim to categorise countries. Instead it aims to provide a tool for policy makers working in states with limited capacity to address the essential needs of their citizens.

To make this handbook more user-friendly, instead of using the full term “states in post-conflict and fragile situations”, we talk about “fragile states”.

More information: Jones, B., *et al.* (2008), *From Fragility to Resilience: Concepts and Dilemmas of State Building in Fragile States*, OECD, Paris.

1. These approaches include the use of public-private partnerships and/or output-based aid (see the Glossary at the end of this handbook and Annex D).

2. See OECD (2009a), *Contracting Out Government Functions and Services: Emerging Lessons from Post-Conflict and Fragile Situations*, Partnership for Democratic Governance (PDG), OECD, Paris.

and Asia,³ were represented at senior level. During that conference, discussion about the possible contradiction between contracting service delivery and building state capacity raised a series of operational issues. Participants agreed that there was no guidance available on how to contract out government functions and services in situations of fragility and suggested that a handbook be developed by the PDG and its stakeholders to fill this gap.

The development of the handbook started in October 2009 with support from international experts and practitioners from developed and developing countries.

The arguments for and against contracting out in fragile states

Contracting out is not a new practice. Developed and developing countries alike often turn to external (public or private) contractors to perform government functions and services, such as the management of customs or the provision of health

services. However, contracting out is not a panacea either. In fragile countries there has been much debate about the wisdom of using external providers for addressing urgent needs and to support public management. This is because, under some circumstances, contracting out can undermine the long-term objectives of state building and capacity development. Some studies have also shown that contracting out government functions and services in fragile and post-conflict situations can even be harmful if services end up being provided through parallel initiatives which bypass country systems. However, recent experiences also demonstrate that contracting out government services is not necessarily a sign of a weak state; on the contrary it can be a legitimate public policy choice made by a resilient state. Similarly, under the right conditions, the impact of contracting out can actually help strengthen a state's legitimacy and accountability to its people, especially if the decision to contract out is made by the government in line with the commitments of the Paris Declaration and of the Accra Agenda for Action on aid effectiveness.⁴

3. Angola, Burundi, Cambodia, Congo, Côte d'Ivoire, Democratic Republic of the Congo, Gabon, Guinea-Bissau, Liberia, Mozambique, Nepal, Sierra Leone, Sudan, Timor-Leste and Togo.

4. For a current statement of progress against the Paris Declaration, see OECD (2009b), *Aid Effectiveness: A Progress Report on Implementing the Paris Declaration*, OECD, Paris.

Who is this handbook for?

This handbook is for **field practitioners** and **government policy makers** in countries that are either emerging from conflict or are otherwise considered to be fragile. Its aim is to help policy makers and practitioners make more informed choices about the types of contracting that are best suited to their country. It is a tool to help policy makers assess whether contracting out might be a possible way forward – either temporarily or over a longer period of time – for delivering a core service (such as basic education, healthcare, water and sanitation) or a government function (such as managing public finances and human resources). It is also designed to be accessible to field practitioners who are

neither procurement nor legal specialists. When developing the handbook, one of our key concerns was to provide sensible guidance adaptable to various situations so that users can make informed (short to medium-term) choices while still considering longer-term sectoral and capacity strategies.

Donors and other stakeholders can use the handbook as a reference tool in their dialogue or partnerships on contracting out with partner governments.

What this handbook is, and is NOT

This handbook intends to provide a roadmap for weighing the pros and cons of contracting out and for navigating the process once the decision to contract out has been taken. It should be clearly stated at the outset that the handbook does not advocate the benefits of contracting out in fragile states. Practitioners should use it to inform their own decisions about whether to contract out or not, and to optimise the options available to them once the decision to contract out has been taken.

The handbook fits within an already extensive literature. Some of this touches upon contracting out specific functions or services in fragile states, and includes country case studies on the contracting out of essential services, practical manuals (some-

times focused on a specific sector such as health), technical guidance on procurement processes in fragile contexts, and legal guidance and templates on contractual and legal arrangements. The handbook contains a short selection of useful reference material at the end of each chapter.

The handbook does not offer a one-size-fits-all approach or a series of templates because blueprints cannot be imposed from the outside. Any contracting-out process should be tailored to the country's specific context. Neither is the handbook a technical manual.

How is the handbook organised?

The handbook has five main chapters. It starts by defining what contracting out is and the political, technical and capacity risks and constraints that exist in fragile states (Chapters 1, 2 and 3). The rest of the handbook (Chapters 4 and 5) helps users navigate through the procurement and contracting process once the decision to contract out a specific function or service has been made.

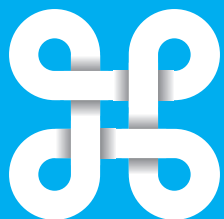
Chapter 1 begins by defining some overarching principles of contracting out, explores the reasons why fragile or post-conflict states might decide to externalise some of their government functions or services, and discusses what these might be. This chapter also provides an overview of the types of contracts that might be used depending on the context and the service being contracted out. It finally addresses different payment mechanisms and modalities.

Chapter 2 examines the interests and incentives of the various stakeholders and the risks that may arise in contracting. It discusses what to consider when deciding whether to contract out or not; proposes how to assess the (positive and negative) incentives of various actors (government, suppliers, recipients, donors) in the process of contracting out; and outlines the risks associated with the contracting out of specific government functions and services in fragile situations.

Chapter 3 looks at how to assess a state's capacity for contracting out: at the levels of the enabling environment, the organisation and the individual. It describes what steps to take if a state is found to be too weak to even oversee contracting out, and how to use contracting out as a way of building state capacity to reassume service delivery in the longer term.

Chapter 4 outlines the steps involved once the decision to contract out has been taken. It offers users an overview of the process and provides guidance on what is needed to plan and implement a credible procurement in order to contract services from the private sector (both for-profit and non-profit organisations). It also offers insights into how to develop a procurement plan, the types of contract that are available and how to handle a possible transition to full partner country management services.

Chapter 5 provides guidance on the legal aspects of contractual arrangements for the provision of government functions or services. It guides users through the approaches that governments can use to structure, negotiate and enforce contracts, taking into account the country's context and legal or institutional capacity. This section also provides legal insights into how to draft and monitor contracts.



Chapter 1

The scope of
contracting out
in fragile states

What's in this chapter?

This chapter covers:

- > The technical definition of contracting out;
- > Why fragile states may decide to contract out certain functions and services;
- > Whether some functions and services are more suitable for contracting out than others;
- > Types of contracts used in fragile states and key elements in contract design; and,
- > Forms of collaboration other than contracting.

Key lessons learned

- > Contracting out in fragile states can address both urgent service needs and longer-term state-building objectives. However, it should only be undertaken after the costs and risks have been assessed.
- > The feasibility of contracting out depends on the capacities of the state and of the non-state contractor. Capacity does not only mean the technical skills and resources at the individual and organisational level, but also in the wider context of institutions and incentives. Contracting out is unlikely to be sustainable without a supportive enabling environment of public sector rules and legal, regulatory and policy frameworks.
- > The implications of contracting out may be different for particular functions or services.
- > Contracting out functions that directly affect the sovereignty of a nation (*e.g.* defence or diplomacy) is bound to be controversial; these are rarely contracted out.
- > Contracting out the delivery of services has fewer implications for the sovereignty and internal functioning of the state than contracting out of internal administration and policy making.
- > Government should retain responsibility for deciding how much decision-making authority it delegates to contractors, and must also retain a “stewardship role” such as operational oversight of any function being contracted out, particularly in matters that go to the heart of the “social contract” between state and citizen (*e.g.* budget allocations).

1.1. What is contracting out?

The main characteristics of contracting out are as follows:¹

- A purchaser uses a contract to obtain or “procure” a service or product from a third party. The purchaser or contracting agency could be a national ministry, a government-owned enterprise or a local government body. The contractor (also referred to as the provider or vendor) delivers the services or products. Non-state service providers can take a wide variety of organisational forms. They include individual experts, private sector firms (local or international), NGOs (local or international), faith-based organisations (FBOs), and community-based organisations (CBOs). In the early stages of post-conflict reconstruction, international private sector companies and international non-governmental organisations (INGOs) are often involved in the provision of services or support to state functions. In some cases, co-operatives are formed to provide the services.² This handbook focuses on contractual agreements in which the state is the purchaser and non-state providers are the contractors.
- An agreement (usually written), which is enforceable by law, sets out the objectives for the contractor. These include delivering outputs or outcomes of a defined quantity and quality, in a particular

location, at an agreed price and for a specified period of time (Loevinsohn, 2008).

- The state retains responsibility for, and control over, the delivery of the service or function even though it may not actually deliver it itself (see Box 1.1). The expectations set out in the contractual agreement allow the state to monitor the performance of the contractors. Performance is usually defined in terms of the quantity and quality of the services delivered.

Contracting out can occur under three scenarios:

1. The partner government executes the contract with funding from its budget.
2. The partner government executes the contract with funding from multilateral organisations, bilateral donors, foundations or other external funding sources.
3. External funding entities, such as donors, finance, execute, and manage the contract for services, in close collaboration with the end users and/or partner government.

The focus of this handbook is mainly on the first scenario. However, in many countries, contracted services or functions are provided through a combination of these three approaches. It is therefore advisable for a partner government to develop a strategic framework that takes into account all three, so that the government is best able to provide comprehensive, effective and efficient service delivery. The government should retain ownership of the process for all approaches (see Chapter 3).

While it is often the case in fragile states that international donors provide the financing and technical support for contracting out, the state can still be considered the purchaser when it has responsibility

1. The Tunis conference “Contracting Out Core Government Services and Functions in Post-Conflict and Fragile Situations”, jointly organised by the PDG and the African Development Bank (AfDB), June 2009, adopted the following working definition: “Contracting out is the transfer of competences and/or authority between a delegating authority (the purchaser) and a third party (the contractor), for a given period of time, based on a contractual agreement”. See OECD (2009a).

2. Contractors can also be public entities, for example a ministry of finance could contract a statistics agency to collect and analyse data and track economic statistics, or a national government could contract a municipal government to register businesses. However, these situations of contracting within government are not the subject of this handbook.

for awarding the contract, the finance is channelled through a public ministry, and when it has a role in oversight and accountability. In exceptional circumstances, where it is not feasible for the state to act as purchaser (*e.g.* in extreme cases of humanitarian crisis, deteriorating security or severe lack of capacity to perform core functions), direct agreements between donors and contractors are sometimes made (OECD, 2008). However, contractual agreements that bypass the state altogether (in which the state has neither an oversight nor a policy-setting role) are inadvisable in all but the most extreme settings, and are outside the scope of this handbook.

Similarly, internal contracting arrangements, between levels of government, are not addressed in this handbook. Such arrangements are sometimes referred to as “contracting in”, although this term is used with different meanings – for example to describe situations where government provides a service but contracts in specific inputs to support its delivery. This handbook uses the term “contracting out” because it more explicitly refers only to relationships between the state and non-state actors.

1.2. Why do fragile states contract out some functions and services?

The provision of essential functions and services is a critical question in fragile states, not only because the population needs services but also because it can help to restore confidence and build trust in the state, in turn addressing the underlying sources of fragility (OECD, 2009).

However, in post-conflict and fragile situations, at least in the short term, there is unlikely to be sufficient capacity within the public sector for delivering the bulk of essential services and functions at the scale required to meet the population’s basic needs and expectations. Typically, governments in fragile states face a complex set of challenges relating to maintaining legitimacy, ensuring security and delivering services to their people. Frequently, they do so in situations where significant portions of the population are displaced, physical infrastructure is significantly impaired, the rule of law is minimal or absent, the private sector is highly informal, and basic services – if they exist – are delivered mainly by NGOs and civil society organisations. Moreover, the government itself is likely to be facing significant operating constraints: legal revenue collections may well be minimal, and government institutions may lack appropriately qualified staff.

In such circumstances, contracting out may be the only feasible option for addressing the government’s immediate delivery challenge.

Contracting out has the following advantages:

- It can allow states with weak capacity and limited resources to avoid the heavy demands of directly providing services and instead to focus on the “stewardship” roles of planning, policy development, setting norms and standards, financing, oversight and regulation (see Box 1.1).
- In post-conflict and fragile situations where state capacity is weak, non-state actors are likely to be the major providers of the services that exist. As contracting out can set and enforce standards on non-state providers, it can help to co-ordinate and rationalise existing provision.
- It can extend the provision of services into remote geographic areas where state structures are absent and non-state actors are better placed to deliver services.
- It allows partner governments to begin to (re-)

establish some degree of social contract between citizens and the state by demonstrating the state's responsiveness and accountability.

- It can help create transparent and accountable institutional and regulatory systems and procedures.
- In post-conflict environments, contracting out is often seen as a transitional strategy to fill temporary gaps in service provision until government can develop the necessary capacity to be able to provide services directly. An example is contracting the provision of health services in post-conflict Liberia (see Case Study 1 in this chapter).

Box 1.1. The state's stewardship role

- Formulating sector strategies and technical policies
- Identifying the roles of public, private and voluntary sectors
- Organising the financing of service provision
- Generating, analysing and using data
- Monitoring the effects of policies and reforms
- Collaborating and coalition building: across sectors within government and with external actors
- Regulation and incentives
- System design
- Accountability to the public

Source: Adapted from WHO 2007, cited in Balabanova, D., Oliveira-Cruz, V. and K. Hanson (2008), Health Sector Governance and Implications for the Private Sector, Working Paper, Results for Development Institute, Washington DC.

Whilst contracting out in fragile states is often initially conceived as a short-term, transitional arrangement to temporarily fill the gap in public sector capacity, it may also be a longer-term public policy choice, based on an assessment of costs and benefits. There are a number of technical reasons why contracting out could be considered beneficial both to the state and to the service or function being contracted. For example, it can increase the focus on measurable results, and encourage greater efficiency through competition, benefiting both direct beneficiaries and the state. But these benefits will only arise where there is competition among providers and the state has capacity to monitor and enforce contracts – neither of which may be

true in fragile states. Contracting out also incurs high administrative and transaction costs, including the costs of negotiating, seeking legal advice, and creating adequate information and reporting systems (see Chapters 4 and 5). These costs should be balanced against the costs of direct provision of services by the state (Table 1.1).

Perceptions about the costs and benefits of contracting out will affect the various stakeholder groups' support for contracting out. These incentives, and the political and technical risks often associated with contracting out, are explored further in Chapter 2.

Case Study 1 Contracting out health services in post-conflict Liberia

During the 14-year civil war in Liberia, approximately 80% of health care was provided by international and national NGOs in a fragmented, uneven system which lacked a co-ordinating policy framework. Following democratic elections in 2005, the new Liberian government faced the enormous challenge of transforming the health sector from emergency humanitarian relief into an integrated health system.

The central Ministry of Health and Social Welfare (MoHSW) recognised that in order to rapidly expand access to basic health services throughout the country, it would need to continue to collaborate with the non-state providers that were already delivering the majority of services to the Liberian people. A new National Health Plan set out the ministry's intention to contract out the delivery of a basic package of health services to non-state providers. A number of stakeholders were subsequently involved in developing the ministry's contracting policy, including donors, technical experts, NGO partners and international consulting firms.

The rationale for contracting out in Liberia, as set out in the 2007 National Health Plan, is to:

- Increase and sustain access to basic services;
- Improve the quality and efficiency of service provision; and
- Develop the capacity of county health teams to resume management of health facilities in the long-term.

Liberia is using contracting out as a tool to build the capacity of the ministry and county health teams to eventually become direct providers once again. To this end, government has undertaken a thorough assessment of its own capacity to manage, monitor and evaluate contracts with NGOs, and service contracts include discrete activities to build ministry capacity for eventual hand back to government.

Lessons learned: In this case, contracting out was successful because the impetus came from within the MoHSW itself, which was in turn able to gain the necessary support from key stakeholders through a transparent process of consultation.

Source: Abramson, W. (2009) "Contracting out Health Services in Post-Conflict and Fragile Situations: Lessons from Cambodia, Guatemala and Liberia", in OECD (2009), Contracting Out Government Functions and Services: Emerging Lessons from Post-Conflict and Fragile Situations, OECD, Paris

Table 1.1. Positive and negative perceptions about contracting out in fragile states

Positive	Negative
<ul style="list-style-type: none"> • Can allow a greater focus on measurable results, accountability and reduces misuse of funds • Can increase effectiveness and efficiency through competition • Can allow governments whose capacity is limited to pass on the delivery role and to focus on roles such as planning, standard setting, financing and regulation • Can allow for rapid expansion of services by bringing in specialist providers • If successful, can slowly mend or rebuild the social contract between citizens and the state • Can allow for the co-ordination of multiple public and private providers 	<ul style="list-style-type: none"> • Can reduce competition among providers • Can involve transaction costs, which may cancel out any efficiency gains • Can increase risk that governments with weak capacity to deliver services and with weak stewardship roles can lose control altogether, <i>i.e.</i> sovereignty can be reduced • Can increase opportunities for corruption • May be perceived as undermining direct provision by government

1.3. Contracting out: implications for the state

Contracting out implies a **shift in the role of the state** from the (possibly more prestigious) activity of directly providing services and functions, to the stewardship or leadership roles listed in Box 1.1. In practice, governments in both industrialised and developing countries often perform a mixture of roles in any given sector, simultaneously engaging in direct provision alongside contracting, regulation or collaboration with non-state actors. For example, the state may deliver education services directly through state-owned and operated schools in some areas, whilst simultaneously contracting out education in others. Hence contracting out may form only one part of an overall sector strategy that incorporates a range of roles for the state.

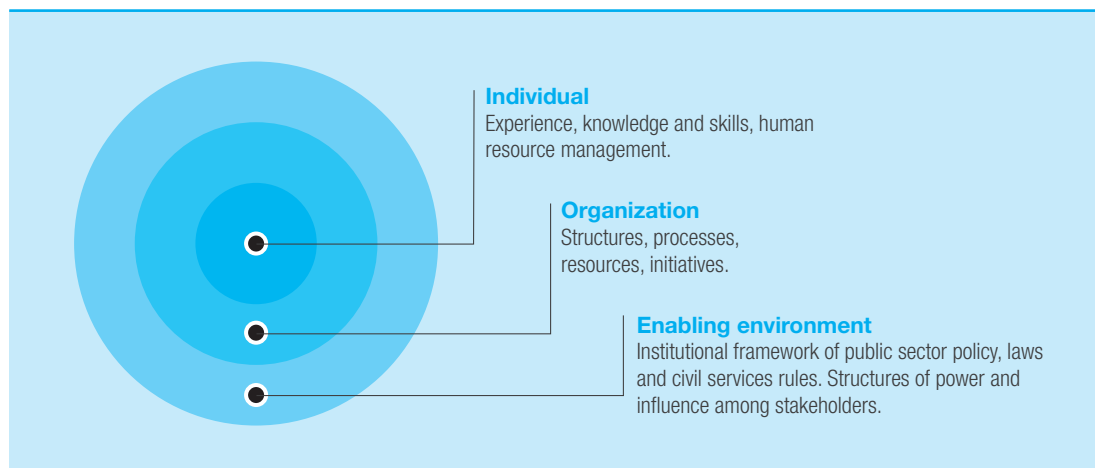
Capacities needed for contracting out

The state's stewardship roles require a different set of capacities than for the direct provision of services and functions. However, governments with weak capacity to deliver services may also have little or no capacity to undertake the stewardship roles.

Contracting out is highly complex and requires some specific skills – both within government and in the non-state sector – if it is to be successful. This “capacity” can be understood and addressed on three levels: the individual, the organisation and within the enabling environment (Figure 1.1). Each of these levels (or types) of capacity are interconnected: individuals need certain skills, knowledge and experience to carry out tasks effectively, but they can only do this within the contexts of organisations that provide them with adequate resources and incentives. In turn, organisations are themselves influenced by the enabling environment – the institutions, and wider structures of power and influence – in which they operate (OECD, 2006).

- **Individual capacity:** Governments need the skills, knowledge and experience of individuals – including political leaders and senior staff – who can mobilise new approaches to service delivery; and of professional staff – such as lawyers and accountants – who can manage the procurement process.

Figure 1.1. Levels of capacity for contracting out



- **Organisational capacity:** structures, processes and resources are required in at least three spheres: (1) contract design (writing contracts, specifying services, estimating costs); (2) management (setting up administrative and financial systems); and (3) monitoring and evaluation (information, systems and resources to perform oversight).

- **The enabling environment:** enforceable rules and legal, regulatory and policy frameworks. Without these, it is difficult for public sector organisations to set standards, ensure contractual rights and, therefore, gain the confidence of contractors (Batley and McLoughlin, 2010).

There may also be profound political and institutional risks to contracting out. This can include resistance by key stakeholder groups, including government, non-state service providers, donor agencies, and service recipients (see Chapter 2).

It is also crucial to consider the implications of contracting out for the **longer-term development of state capacity** either to perform stewardship roles or to (re-)assume direct provision of the function

or service. There is a common perception that contracting out may reduce incentives for governments to develop their own systems and processes for providing services or functions directly. In principle, there is no reason why contracting should undermine the development of state capacity, so long as the state retains a strategic role in setting the policy framework and service standards, and monitoring the performance of the contracts, and so long as its capacity to undertake these roles is developed as part of the contracting-out process. Where the aim is to transfer the function or service back to the state in the short to medium-term, capacity development measures can be included in contracts (see Chapter 3).

Understanding and addressing capacity needs and capacity development are vital to the feasibility of contracting out. Capacity issues are considered throughout this handbook (see Chapter 3 in particular).

>TIP: Basic individual and organisational capacities can be developed incrementally by learning through experience, beginning with smaller scale and less complex contracts.

1.4. What can and cannot be contracted out?

As a starting point, the question of whether or not a function or service is suitable for contracting out can be framed within a wider understanding of the responsibilities and roles of the state. In order to become more resilient and stable, fragile states need to be able to fulfil certain core functions in response to social expectations of what the state should do (OECD, 2009).

There is a great deal of debate about what these core (or essential) functions are. However, there is some consensus that fragile states need capacity in the following areas: law-enforcement and citizen protection, justice and conflict resolution, raising and expending

revenues, providing the basic services that underlie the Millennium Development Goals, and facilitating economic development (OECD, 2009; Box 1.2). It is important to recognise, however, that social expectations of the state will be different in every context as they are formed through social norms about the role of the state, its historical performance, and the extent to which there is a reciprocal relationship between state and citizens. For example, in some contexts citizens will not expect the state to be able to deliver health or other basic services if it has never done so before. In some conflict-affected situations, some groups may not trust the state to do so and would rather rely on traditional and informal mechanisms.

Box 1.2. Core state functions

The core functions of government include:

- The exercise of sovereignty (such as approving and enacting state law, setting taxes and conducting international relations); the options for contracting these functions are limited.
- The internal administration of the state (such as public finances and human resources), which

present possibilities for contracting over defined periods.

- The delivery of essential services (for example basic education, healthcare, water and sanitation) to consumers. For these functions there is no limit on the scale and duration of contracting, although government policy may decide to place time limits on them.

Some state functions are considered to constitute **state sovereignty** and cannot therefore be performed by a non-state entity. These include providing security and safety within the state's borders, managing international relations, engaging in diplomacy, gathering intelligence, and defending the nation. These functions are highly political, and are essential for state sovereignty in that they allow the state to be accepted into the international system of states. Governments are likely to be very reluctant to contract out these functions. The only option might be to contract specific expertise to support government delivery.

Similarly, there are **policy-making aspects** of state functions and services that may be inadvisable to contract out to a third party. These include setting the policy framework, and making decisions about functions or services. Contracting out policy making does occur in fragile states, but it is usually limited to providing support and advice in assessing policy options, developing policies and setting service standards. In principle, the responsibility for making decisions cannot and should not be devolved to a non-state entity. For example, whilst the state may contract out some aspects of budget design, it should not contract out decisions about budgetary allocations or priority setting. These are public decisions that should be made by public (elected) officials because they go to the heart of the “social contract” between state and citizen (OECD, 2008).

More broadly, government may closely guard the **internal administration** of certain functions at the heart of the machinery of government and which may impinge on state sovereignty. This is particularly the case for public financial management, legal services and the management of natural resources. Contracting out internal aspects of these functions can be risky because it can provide privileged access to government information. A further risk is that it gives contractors monopoly control over aspects of internal administration. Nevertheless, discrete tasks for performing these functions are often

contracted out in fragile states; examples include procurement (**Afghanistan, Southern Sudan**), customs (**Angola**, Box 1.5; and **Mozambique**), tax collection (**Sierra Leone**), public financial management (**Afghanistan, Liberia**) and accounting and auditing (**Southern Sudan**). The intention of these contracting-out arrangements has often been to set up systems, train and develop staff so as to enable the service to eventually be handed back to the state. Case Study 2 illustrates this for contracting out core functions in **Afghanistan**.

Contracting out the **delivery** of functions and services is likely to have less impact on the sovereignty and internal functioning of the state. The delivery of state functions includes the actual implementation and operation of the function at the interface with citizens (either as consumers or beneficiaries). Thus, for the provision of basic services, delivery involves operating and managing the services as opposed to setting the policy framework. This does not impinge directly on the state's own internal administration and frequently allows government to exploit competition between rival contractors. This is commonly practised in fragile states for basic social services (particularly healthcare, but also some aspects of education and welfare); infrastructure (water supply, sanitation and refuse disposal, roads, energy, telecommunications); business development; agricultural extension services; and some aspects of security and justice (police administration, legal aid, and maintenance of court houses, police stations and prisons). Examples include contracting out the delivery of health provision (in **Liberia**, the **Democratic Republic of the Congo**, **Afghanistan**, **Southern Sudan** and **Rwanda**), and public utilities and waste management in **Gaza**.

Table 1.2 summarises the scope for contracting out policy making, internal administration, and service delivery.

Case Study 2 Contracting out core functions in Afghanistan

A number of government functions have been either partially or fully contracted out in Afghanistan. Many of them are central to the everyday administration of public services. After 30 years of conflict, the post-2002 interim government inherited a weak civil service, few human resources, and non-existent information technology. Most existing functions needed to be reformed, and many of them rebuilt from scratch. Contracting out – either to NGOs or private firms – occurred widely, including for:

- public financial management (technical support to the Ministry of Finance);
- legislative drafting (setting income tax policies, budget law, procurement law, etc.);
- treasury reform (setting up a national payroll system);
- reform of customs and revenue (setting revenue policies);
- justice sector reform (training judicial staff);
- private sector development (setting up a business

registration service, drafting laws, setting up an export promotion agency);

- budget-making (budget preparation, developing budget operating systems).

Some experiences of contracting out have been more successful than others. Government still lacks capacity in core sectors, and has continued to struggle with performing its basic administrative functions.

Lessons learned:

- Government must be responsible for determining how much decision-making authority it delegates to contractors, and must oversee any function being contracted out. Government ownership of decisions about contracting out is paramount.
- Sound monitoring and evaluation of contractors is necessary to ensure good results.
- Having a plan for the development of government capacity is key. In addition, if it intends to take back the service, government should develop a credible exit strategy for non-state contractors.

Source: Ghani, S., and Nematullah, B. (2009), "Contracting out Core Government Functions and Services in Afghanistan", in OECD (2009), *Contracting Out Government Functions and Services: Emerging Lessons from Post-Conflict and Fragile Situations*, OECD, Paris

Table 1.2. The scope for contracting out

Policy making	Internal administration	Service delivery
Less suitable		More suitable
<ul style="list-style-type: none"> • Contracting in expertise for discrete tasks on a short-term basis > But government retains control over decision-making 	<ul style="list-style-type: none"> • Contracting in expertise for discrete tasks on a short-term basis • Contracting to build state (individual and organisational) capacity for performance of the task over the longer term 	<ul style="list-style-type: none"> • Short to medium-term contracting > But government retains decision-making and oversight functions

Contracting out is less controversial where the functions and services do not impinge on the sovereignty of a nation. It is also easier where the services are specific, discrete and measurable rather than multi-faceted and complex. For instance, it is simpler to contract out the provision of birth certificate registration services (a simple service) than it would be to contract out the creation and running of an entire health information system (a complex set of services).

However, the scope of contracting out in fragile states has more often been driven by necessity than by design. Lack of state capacity and an urgent need for essential functions and services mean that often aspects of all functions are contracted out.

>TIP: Contracting out the delivery aspects of functions and services is more straightforward and has fewer implications for the sovereignty and internal functioning of the state.

1.5. Types of contracts

This handbook refers to three broad categories of contracts: management contracts, service contracts and works/supplies contracts. These are the more common types of contracts used in fragile states (Annex C contains a fuller list of contract types and Chapters 4 and 5 discuss contracts in more detail). Table 1.3 summarises the characteristics of each of these types of contracts and Box 1.3 gives examples from developing countries.

- **Management contracts:** an arrangement under which a non-state actor operates and manages a publicly-owned enterprise, organisation or facility. This could include the management of health

facilities or a water company (Box 1.3) for example. A management contract is generally used in areas where government is not achieving adequate results.

- **Service contracts:** a contract for a specific technical task that enhances a government-run function. Examples include hospital cleaning or water billing.
- **Works/supplies contracts:** one-off or spot contracts for construction or providing supplies (*e.g.* drug or condom supply, Box 1.3). They are the simplest type of contract since they are short term and the most tangible and easiest to measure.

Table 1.3. Types of contracts

Contract type (typical duration)	Asset ownership	System operation	Types of activity	Examples
Management contract (3-5 years)	Public	Private	Management tasks over a short period	Water company management, road maintenance
Service contract (<3 years)	Public	Private for specific services	Specific technical task	Hospital cleaning, water billing, supporting IT or payroll systems
Works/supplies contract (one-off)	Public	Public with private inputs	One-off (<i>e.g.</i> building or supplies)	Building work, training, drug supply

Box 1.3. Examples of management, service and supply contracts**Management contract, Ghana**

In 2005, the Ghana Water Company (GWCL), supplying half the population, faced financial difficulties and was not able to carry out the repairs, renewals and extension of networks needed to operate the service. The country adopted a new law for the water service in order to increase the role of private operators in its management (through management contracts). In 2006, GWCL signed a management contract for five years with the company Aqua Vitens Rand (AVRL). But two years after the implementation of the contract, many customers still had no water. AVRL blamed a lack of investment; it appears that the success of management contracts depends on the ability of public authorities to mobilise external funding (concessional loans, subsidies) and their involvement in the implementation of the investment programme (Gwénola, 2008).

Service contract, Afghanistan

Until 2002, around 80% of Afghanistan's health facilities were operated by NGOs that were contracted by donors and who received funds directly from them. The Ministry of Public Health was not involved in the contracting process. Now the exter-

nal grants from donors are provided either through the Ministry of Public Health or in close collaboration with the ministry. The ministry contracts out NGOs to provide a basic package of health services (BPHS). Contracts are with international and Afghan organisations such as Save the Children, the Swedish Committee for Afghanistan, HealthNet International, and Ibn Sina, a large Afghan NGO. Monitoring these contracts includes progress reports and site visits by the ministry, as well as a third-party contract to monitor services using household surveys, inspections of facilities, and interviews.

Contract for supplies, Haiti

In 2000 the Haitian government, using World Bank funding, agreed to contract with Population Services International (PSI) for contraceptive supply for family planning and HIV/AIDS prevention programmes. PSI had been supplying these for years under contracts directly with donors. An initial contract of USD 700 000 covered the costs of procuring and packaging condoms. A subsequent contract includes USD 250 000 for condom purchase, and another USD 150 000 for distribution and marketing.

In practice, contracts can combine both management and service contracts, as in the example of customs reform in **Angola** (Case Study 3).

Management, service and works/supplies contracts are medium to short-term agreements in which the state retains ownership of the assets and provides the capital financing. They are for specific tasks. Longer-term arrangements, which allocate more managerial and financial responsibility to the private sector, are also possible, although they are not common in fragile states. These include leases, concessions and build-operate-transfer (BOT) contracts. Leases are long-term contracts (usually 10-12 years)

in which the private sector operates and maintains a publicly-owned asset (such as water supply). Concessions are similar arrangements (usually 20-30 years) where the private sector operates, maintains and invests in a publicly-owned asset. BOT arrangements (usually 20-30 years) involve private investment and operation of assets with a view to their transfer into private ownership.

It is highly questionable whether fragile states should enter into long-term agreements, particularly since the decision to contract out in fragile or unstable contexts is often taken urgently, sometimes before there is adequate public sector capacity for proper

planning or policy making. In addition, there is unlikely to be the full information required to anticipate all the risks and implications of very long-term agreements, and there may also be few competitors. Moreover, in fragile situations, contractors are likely to be unwilling to take on long-term responsibilities that involve investing their own funds in physical assets. Because these arrangements are neither advisable nor prevalent in fragile states, they are not addressed in this handbook.

>TIP: The main types of contracts used in fragile states are management contracts, service contracts and works/supplies contracts. These types of contracts are likely to be for a maximum of five years. It is questionable whether longer-term agreements are feasible or desirable in low-capacity and/or unstable environments where options have to be re-assessed frequently.

Case Study 3. Customs sector management and training contract in Angola

Angola's National Directorate of Customs contracted the private sector consultants Crown Agents to support the implementation of a Customs Expansion and Modernisation Programme (CEMP) in March 2001.

Crown Agents trained (under a service contract) and managed (under a management contract) government staff for tax collection. The contract included a specific capacity development element in the form of a Business Management Development Programme to increase the organisation's management competence. Guided by a human resource strategy, training was delivered which included both theoretical and applied sessions. Staff members who participated were relatively inexperienced managers, but all were enthusiastic and willing to learn and apply the management principles. A training-of-trainers programme was implemented under several partnership agreements to improve the training skills of senior managers.

Key results of the CEMP include:

- Revenue collected from customs increased by

394% (from USD 215 million in 2000 to USD 1 062 million in 2005).

- Dependence on the contractor was reduced.
- 434 training courses were held, building the capacity of over 6 000 participants.
- Employment policies were developed (e.g. on code of conduct, uniforms, job group reclassification, English language skills).

It is important to highlight that the end of the civil war coincided with the beginning of the project, and might have played a role in the increased revenue collection after the government recovered full territorial sovereignty.

Lessons learned: The success of the programme has improved trade operations in Angola, which is beneficial for importers and local businesses. While the impact of the programme on citizens may be indirect, the more efficient system promotes a more modern overall environment in the country.

Source: OECD (2009), Bridging State Capacity Gaps in Situations of Fragility, Partnership for Democratic Governance, OECD, Paris

1.6. Key elements of contracts

The three main categories of contracts (management, service and goods/supplies) can all vary in form. The form of the contract depends on its design, including its scale and duration, the use of performance measures, risk distribution and payment mechanisms. These and other elements of contract design are explored in detail in Chapters 4 and 5. As a starting point, some of the key elements to consider when deciding on the appropriate approach for contracting out are:

- **Sole-source versus competitive awards:** A contract can either be awarded to a sole provider, or through a competitive bidding process (see Chapter 4). Sole-source contracting is sometimes used in fragile states on an interim basis to fill urgent service delivery gaps. It can avoid the need for time-consuming competitive bidding which may not always be feasible when urgent services are needed. For example, an interim short-term sole-source contract was used for project accounting in South Sudan.³
- **Distribution of risk:** Contracting out necessarily involves spreading the risk between the purchaser and contractor (Walsh, 1995). How the risk is distributed will depend on the contract terms, the price levels set, administrative costs, and the costs of supervision, amongst other factors. Chapters 4 and 5 explore risk distribution mechanisms further.
- **Level of formality:** The formality of a contract is the degree to which it is set out legally and in writing. Contracts can range in level of formality from: (1) a verbal understanding; to (2) a written but not legally registered agreement (*e.g.* the signing of a memorandum of understanding, MOU); to (3) a written and legal contract. Verbal understandings or non-binding written agreements require less technical and administrative capacity than formal contracts, since they are based on relationships. In practice, the majority of agreements between government and non-state actors in countries where there is little capacity are likely to be informal, given the urgency of provision and the weak capacity of the parties. Under these circumstances, this may be an acceptable approach; it should not be assumed that it is feasible or desirable to formalise informal agreements between state and non-state actors. This is explored more in Chapter 5 and Annex C.
- **Level of specification:** There is also a question about whether a formal written contract can, or should, specify particular inputs or outputs, or whether it should leave the contractor free to decide the outcomes to be achieved. In practice, even formal contracts are often “incomplete” – they cannot usually specify all the outcomes the parties may want or expect; nor can they predict and account for all the circumstances that might arise or how these might be addressed. In the often unpredictable environment of fragile states, contracts may be even less complete, not least because there may not be the necessary capacity or information required to set realistic targets for providers (see Chapter 5).
- **Relational element:** In practice, most contracts are not purely formal, impersonal or legal. If they are successful, they are usually based on a relational element – *i.e.* trust, experiences of past benefits and belief in the future value of the relationship. This is particularly likely, and necessary, for long-term contracts.

3. For a fuller discussion of experience of using sole-source contracts in South Sudan, see Davies, 2009.

• **Performance measures:** Performance-based contracting provides incentives (usually payment) for good performance. It may also include sanctions for poor performance. Performance measures are usually based on specified and measurable inputs (*e.g.* materials, labour), outputs (*e.g.* goods, services provided), or outcomes (longer-term impacts on target group/community) (see Table 1.4). Inputs, outputs and outcomes are likely to be more specific (and specifiable) where the services being purchased are narrow in scope and easiest to measure (*e.g.* vaccination programmes), than where the services being contracted are broader and therefore harder to measure (*e.g.* literacy programmes, whose measurement requires a sophisticated and costly audit system).

In fragile states, it may be more feasible for performance to be measured in inputs and outputs, rather than outcomes. Outcome-based contracting is an advanced tool. Rigorous evaluation skills are needed to identify the links between a contract's outputs and its long-term outcomes. Input-based contracts are sometimes used on an interim basis in situations

where it is difficult to specify outputs (*e.g.* contracting emergency medicine in remote areas), but output-based contracts are far preferable in that they can make the contractor accountable for the quality and quantity of services and goods delivered.

Output-based aid using public funding (including donor contributions) can drive the use of performance measures in contracting-out arrangements. Annex D illustrates how output-based approaches have been used in fragile states.

>TIP: The form of the contract (*e.g.* level of specification, performance measure and formality) will to an extent be determined by the capacity available, including the wider enabling environment.

- It may be neither feasible nor desirable to formalise or over-specify terms in fragile states.
- It may be more feasible for performance to be measured in terms of inputs and outputs, rather than outcomes.

Table 1.4. Measuring inputs, outputs and outcomes

	Inputs	Outputs	Outcomes
Definition	What the contractor puts in (<i>e.g.</i> materials, equipment, labour) to achieve desired outputs or outcomes	Goods and services delivered to achieve desired outcomes	The end results, or consequences, for the target population or environment
Ease of measurement	Directly and easily measurable	Directly measurable	Measurable only over medium to long term through rigorous evaluation
Example	In a labour contract, the contractor is paid on the basis of staff time provided	In a unit-price contract, the contractor is paid by the unit of services performed (<i>e.g.</i> for each inoculation given)	Specifying improved health indicators in a target area/population group (<i>e.g.</i> reduced malaria morbidity)

1.7. Beyond contracts: other forms of collaboration between government and non-state actors

There are a number of other forms of collaboration between the state and non-state actors which often have similar goals to contracting out but which differ in terms of the formality of the agreement, and the division of roles, responsibility and authority. In practice, the boundaries between contracting out and other modes of collaboration are often blurred. The main alternative modes of collaboration are defined below and illustrated in Table 1.5:

- **Grants:** a mechanism for funding non-state actors to deliver a service, activity or project of their own design. In principle, the key distinction between grants and contracting out is who defines the services to be delivered. In the case of grants it is the non-state actor (usually through a written project proposal); in contracting out it is the purchaser. However, this distinction is not always absolute. Often the provision of grants does involve the state imposing conditions on the services to be delivered, such as ensuring they are coherent with the national sectoral strategy. Funding usually depends on the non-state provider meeting those conditions. These are also characteristics of contracting out agreements.
- **Mutual agreements:** unlike contracting-out, mutual agreements do not involve a transfer of competencies and/or delegation of authority from a purchaser to a contractor. Instead, they involve the state and non-state actors deciding voluntarily to plan and act together, contributing separate funding to common or complementary ends and taking on distinct roles in the provision of a particular service or function (Batley and McLoughlin, 2010). These agreements are not enforceable by law, but rather by the possibility of repeat transactions, and by reputation. The penalty for failure is simple: termination of the agreement and the risk of loss of reputation.
- **Co-production:** the provision of public services through relationships between the state and organised groups of service recipients in which both make resource contributions. These relationships are likely to be informal, and involve a division of power, authority and control over resources (Joshi and Moore, 2004).
- **Public-private partnerships (PPPs):** arrangements in which a state service is funded and operated through a partnership between the state and one or more non-state organisations. They involve more mutual commitments than a contract and, unlike contracting out, may have no legal basis (Bovaird, 2004). PPPs often involve private sector investment or commercial control over assets. They encompass a much broader range of collaboration and alliances between the public and private sector than contracting out.

Table 1.5. Different forms of collaboration

Form of collaboration	Distinction from contracting out	Example(s)
Grants	<ul style="list-style-type: none"> • Non-state actor defines services to be delivered 	Grants to NGOs for HIV/AIDS prevention and anti-retroviral treatment, which are widespread across Africa.
Public-private partnerships	<ul style="list-style-type: none"> • Mutual commitments over and above that implied in any contract • May have no legal basis • Often involve private sector investment or commercial control over assets • Encompass a much broader range of collaboration and alliances 	In Côte d'Ivoire , water supply is operated through a private company within the framework of public ownership and investment in infrastructure. The commercial risk is shared between the private operator and the public authority.
Mutual agreements	<ul style="list-style-type: none"> • Do not involve a transfer of competencies and/or delegation of authority • Parties contribute separate funding for common or complementary ends 	In the Democratic Republic of the Congo NGOs support the state's tuberculosis programme in remote provinces (Ndongosieme <i>et al.</i> , 2007)
Co-production	<ul style="list-style-type: none"> • Relationships are between the state and organised groups of service recipients • Informal division of power, authority and control over resources 	In Pakistan (Karachi), a Citizen-Police Liaison Committee, run by the local business community, provides intelligence services and support to the police. The committee brings technical expertise, social credibility and private sector resources into policing, but works largely through informal institutional arrangements (Masud, 2002).

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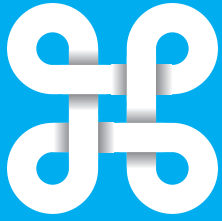
Useful resources

Guidance on forms of contract and capacity

1. Batley, R. and Larbi, G., 2004, 'Working with Private Partners', Chapter 6 in 'The Changing Role of Government: The Reform of Public Services in Developing Countries' Palgrave, Macmillan.
www.idd.bham.ac.uk/staff/pdfs/wwpp.pdf
This chapter describes alternative types of contract, and the factors that need to be considered in assessing the capacity of partners to undertake them.
2. Brinkerhoff, D., 2010, 'Developing capacity in fragile states', *Public Administration and Development*, 30 (1):66-78.
<http://onlinelibrary.wiley.com/doi/10.1002/pad.545/pdf>
This article discusses what is meant by capacity and approaches to capacity development, in the particular conditions of fragile states.
3. OECD (2009), *Bridging State Capacity Gaps in Situations of Fragility, Partnership for Democratic Development*, OECD, Paris.
<http://oecd.org/dataoecd/1/18/42416165.pdf>
A series of case studies which identifies specific bottlenecks and successes when using technical assistance in core government functions and services.
4. OECD (2006), *The Challenge of Capacity Development: Working Towards Good Practice, DAC Network on Governance (GOVNET)*, OECD, Paris.
<http://oecd.org/dataoecd/4/36/36326495.pdf>
An analytical and conceptual framework to help policy makers and practitioners think through effective approaches to capacity development.

Case Studies

1. Loevinsohn, B., 2008, 'Performance-based Contracting for Health Services in Developing Countries: A Toolkit', The World Bank, Washington
<http://siteresources.worldbank.org/INTHSD/Resources/topics/415176-1216235459918/ContractingEbook.pdf>
A practical guide to contracting non-state providers to deliver health services. It discusses the challenges and debates surrounding whether and how to contract and reviews case study material.
2. LaRocque, N., 2007, *Contracting for the Delivery of Education Services: A Typology and International Examples*, New Zealand Business Roundtable
www.hks.harvard.edu/pepg/PDF/events/MPSPE/PEPG-05-07larocque.pdf
An overview of international examples of contracting with the private sector (including the not-for profit sector) for the delivery of educational service.
3. Davies, F., 2009, *Contracting out Government Functions and Services in South Sudan* from OECD, 2009, *Contracting Out Government Functions and Services: Emerging Lessons from Post-Conflict and Fragile Situations*, OECD
<http://oecd.org/dataoecd/56/61/45875056.pdf>
This chapter explores examples of contracting out in Southern Sudan from a number of sectors, including public procurement and health, and provides several recommendations.



Chapter 2

Managing incentives and risks

What's in this chapter?

Considering whether a function or a service is suitable for contracting out is only one part of the assessment process. Questions of political incentives and technical capacity also need to be taken into account. Chapter 2 examines the major political and technical factors that need to be considered when deciding whether or not to contract out. The chapter will cover:

- > The potential sources of support and opposition from various actors that affect the incentives and counter-incentives for contracting out in a fragile state, and the interplay between them.
- > The potential political and technical risks involved in contracting out, and how they can be reduced.

Key lessons learned

- > The **incentives** for contracting out in fragile states will vary from situation to situation, and from actor to actor (governments, service users, contractors, donors). They may also vary over time, depending on the way that contracting out is designed and implemented and on how the balance of power evolves in the country.
- > Contracting out is vulnerable to **political risk** when the incentives for contracting out have not been adequately assessed, and where a decision to contract out is taken without sufficient support, understanding or willingness to collaborate amongst the key actors.
- > Political risk can be reduced by actions aimed at removing negative incentives and creating positive ones. However, it is not possible to completely avoid political risks.
- > Contracting out is vulnerable to **technical risk** when there are gaps in the capacities, legal or regulatory systems, information and the way markets are supposed to function.
- > Technical risk can be reduced by developing government systems essential for contracting out, appropriate contract selection and design, and the provision of technical support.
- > The **interaction between political and technical risk** may alter the overall risk profile and chances of success of the contracting out process.

2.1. Incentives for contracting out in fragile states

Ultimately, it is up to the government of a fragile state to decide whether to contract out some of its functions and services. However, the government is not the only actor in the process; donors (if providing funding), service providers and service users are all key stakeholders, and each is likely to have different interests and incentives for contracting out. The incentives of each group of actors may be either positive or negative, and are likely to vary according to the situation and over time. Incentives may also vary between stakeholders within a group, depending on their different viewpoints.

The challenge for government – and, to an extent, donors – is to assess key stakeholders' incentives before deciding whether or not to contract out. This assessment should evaluate what is at stake for each of them. Who stands to benefit from the decision to contract out? Who are the potential losers? Will the losers become a significant obstacle to the success of the process? What is their capacity to undermine the process and its success?

The incentives of the key stakeholders, including government, will depend on the political context, and will need to be assessed case by case. Some of the potential positive incentives for each stakeholder group are outlined below (and see Table 2.1).

Government incentives and disincentives

For government, the **positive** incentives for contracting out may include the desire to:

- Provide basic services urgently required by the population which the government cannot manage to deliver itself.
- Increase state legitimacy through greater responsiveness and accountability towards its citizens and, if contracting out enables the government to extend its reach to areas or functions where its presence

was previously minimal, to assert authority.

- Provide a visible peace dividend, particularly if social services are being provided.
- Co-ordinate and own otherwise *ad hoc* donor-supported interventions.
- Ensure that non-state providers of basic services operate within the framework of government policies and standards.
- Improve the efficacy of the state as an administrative organisation and service provider.
- Provide services in remote geographical areas where direct provision would not be possible.
- Improve performance management, as it may be easier to dismiss poor quality third party providers than public sector employees.
- Work outside overly rigid public sector administrative frameworks, particularly recruitment policies and terms and conditions of employment.

Government may also face a range of **negative** incentives for contracting out:

- Perception of a politically unacceptable loss of sovereignty and control over the management of government affairs. This may particularly be the case for contracting out internal or policy-making aspects of government to international, profit-making companies. Chapter 1 provides an overview of which types of government functions and services may be the most amenable to contracting out.
- Perceived loss of individual role or authority by certain groups of government, such as senior officials of ministries previously involved in

administering services directly; lower levels of government previously mandated to oversee the direct provision of services; and frontline service providers such as health workers or teachers who sometimes enjoyed a high degree of discretionary power in their sector.

- Reluctance to enter into direct relationships with third-party service providers, particularly non-governmental and civil society organisations (NGOs and CSOs), with whom the government may have a history of mistrust and which it may see as political rivals.
- Reduced opportunities for government officials to dispense patronage or to profit from rent seeking. This may particularly apply to those entities in government which previously administered the relevant functions directly.

>TIP: An assessment of the incentives and counter-incentives for government should take into account the fact that government is not necessarily a homogenous entity; different stakeholders within government may hold different incentives, depending on their position. Assessing the balance of power and interests among these groups is essential to understanding how much support for contracting out exists within government (e.g. the Ministry of Planning, Ministry of Finance and line ministries), where that support lies, whose influence is going to have more bearing on the contracting out decision, and whether it will prove possible to contract out taking these elements into account.

Donor incentives and disincentives

For donors, the positive incentives for government-led contracting out may include the desire to:

- Provide urgent services: contracting out can enable the state to provide or receive urgent services which it lacks the capacity to provide itself.
- Develop state capacity: this is a priority for international donor engagement in fragile situations (OECD, 2008).
- Enhance state legitimacy and accountability: citizens receive services and the state works in partnership with a range of service delivery agents, thereby reducing the possibility of conflict and/or government collapse.
- Increase government engagement in strategic planning, and enhance its supervisory role.
- Increase government ownership of service delivery objectives.
- Align donor support with government systems.
- Provide services in remote geographical areas which the state cannot reach in the short term.
- With performance-based contracts, provide assurance that public funding is being well spent since pre-identified outcome or outputs can be independently verified, thus reducing waste or inappropriate allocation of funds.

OECD donor countries are committed to the Paris Principles on Aid Effectiveness and the Accra Agenda for Action (AAA), which emphasise the importance of government ownership of development processes and the alignment of donors' initiatives with government policy. Nevertheless, donors may not always be in favour of financing government-led contracting out for the following reasons:

- Concerns about the government's capacity: donors may be reluctant to hand service delivery control to the government, particularly if donors previously directly contracted service delivery through third-party providers.
- Concerns about the fiduciary (financial and procurement) risks involved in allowing a government to finance contracts using donor funds, particularly as it could increase opportunities within government for patronage and rent seeking.
- Concerns over the ethical or professional values of potential third-party providers, which may not be wholly aligned with donor principles on issues such as universal human rights.

However, donors – like governments – are not homogenous. Some may be in favour of government-led contracting out and willing to provide financing, while others may be either unwilling or unable to support the process.

Incentives and disincentives for non-state service providers

For non-state service providers, the positive incentives for entering into contracts with government may include the opportunity to:

- Provide services in line with their mission and purpose.
- Access longer-term, more predictable funding, particularly for NGOs and civil society organisations which may only receive short-term humanitarian funding for providing services.
- Enter into transparent (if the selection process is competitive) and secure arrangements as (1) outputs and unit costs are pre-agreed, (2) payment process are clearly defined in the contract (*e.g.* specifying what documentation is needed to obtain payment); and (3) outputs are independently verified.
- Be part of a permanent dialogue with governments, users and donors; this is particularly important for NGOs.
- Enter new markets or scale up operations.

However, service providers may also have a number of concerns which reduce their willingness to enter into third-party contracts with fragile governments, including:

- The security implications of being seen as an agent of government, particularly where sections of the population remain hostile to government.
- Concerns (on the part of NGOs) over whether being a government agent may erode their autonomy and capacity to advocate.
- Concerns over whether government capacity weaknesses will make the initial contracting process difficult and time-consuming, and prevent government from being willing and/or able to meet its financial obligations to them.

Some service providers may prefer direct contractual arrangements with donors, particularly in situations where such arrangements already exist, and where donors are considered a more reliable contractual partner than government. On the other hand, providers that are already in partnership with government may seek to protect their current arrangements against the “threat” of open contracting, in order to secure a higher return from or greater monopoly over service delivery.

>TIP: Governments should analyse whether non-state service providers are capable of scaling up their operations to cover larger geographical areas and to increase their number of service recipients, and whether they have the organisational and financial capacity to enter into formal contractual arrangements.

Table 2.1. Stakeholders' incentives and disincentives for contracting out

	Positive incentives	Disincentives
Government	<ul style="list-style-type: none"> • Enhanced legitimacy and authority • Visible peace dividend • Increased co-ordination and ownership • Bringing contracted non-state provision into the framework of government policy • Improved efficacy of the state as an administrative organ • Enhanced flexibility for performance management • Circumvention of rigidities in public sector administrative framework 	<ul style="list-style-type: none"> • Perceived loss of role/authority/sovereignty • Reluctance to associate with third-party service providers • Loss of opportunities for patronage and rent-seeking
Donors	<ul style="list-style-type: none"> • Increased capacity of an otherwise fragile state • Increased government ownership of service delivery • Increased strategic planning by government • Potential to mobilise a wider range of service delivery agents • Promoting the aid principle of government ownership 	<ul style="list-style-type: none"> • Financial concerns about government involvement in donor-financed contracting • Reluctance to cede control over decision-making to government • Concerns over ethical or professional values of third-party providers
Service providers	<ul style="list-style-type: none"> • Opportunity to fulfil mission and purpose • Longer-term, more predictable funding • Opportunity to engage in dialogue with government and donors • Opportunity to enter new markets 	<ul style="list-style-type: none"> • Security concerns • Erosion of independence as a government contractor • Capacity weaknesses in government • Preference for direct contractual agreements with donors
Service recipients/users	<ul style="list-style-type: none"> • Provision of critically needed services • Enhanced efficacy of the state • Welcome services which are culturally appropriate 	<ul style="list-style-type: none"> • Service providers perceived as having different values • Minimal local involvement • Fear of user charges

The views of service recipients

The views of the general population – those receiving the services – are often neglected in fragile environments, either because of the difficulty of soliciting them when an urgent decision needs to be taken, or because their opinions are not considered sufficiently important to be taken into account. Nonetheless, the attitude of service recipients towards third-party service delivery may affect the ultimate success of the contracting out process. Service recipients may welcome non-state delivery of government services because it:

- Ensures critically needed services where none were previously available, particularly in post-conflict situations.

- Improves the state's effectiveness, increases service delivery, and thus improves people's well being.
- Enables services to be provided by a preferred agency (for example, when health and education services can be delivered by a religious institution that reflects and practices widely-held community beliefs).

On the other hand, people may reject non-state delivery of government services if providers' values are not aligned with their own, particularly their religious or ethnic affiliation. They may also reject service providers which they consider to have been imposed upon them, or which they suspect may charge for services which were previously free.

2.2. The political and technical risks of contracting out

There are two main types of risk involved if government and/or donors proceed with contracting out without having assessed the prevailing incentives/technical capacities properly: political and technical risks. If inadequately dealt with, these can significantly reduce the success of the contracting out process.

Political risk arises when the incentives for contracting out have not been adequately assessed, and a decision to contract out is taken without sufficient support or understanding amongst the key stakeholders. This could include circumstances in which there is:

- **Limited government buy-in:** Contracting out will mainly be sponsored by donors when there is limited government ownership, either because government does not consider the function a priority, or because it is not convinced it should be contracted out. As a result, although government may agree to the donors' proposals, it may not

be committed enough to implement it or it may continue with parallel initiatives. Both actions will undermine the success of contracting out.

- **Lack of consensus within government:** some government stakeholders are committed to contracting out (the "reformers") and using donor funding, some withhold support (the "fence sitters"), while others actively seek to undermine the process (the "opposers"). If the reformers carry less weight within government than the fence sitters and the opposers, then the success of the contracting out process is likely to be limited. Nevertheless, positions may change in situations of crisis where stakeholders are forced to rethink the service delivery model (*e.g.* this occurred after the **Haiti** earthquake of 2010).
- **Rapid turnover of key decision-makers in government:** this can mean that policy making is unstable – a decision to contract out today could be reversed tomorrow.

- **Resistance from lower levels of government:** if contracting out is decided by central government without first consulting and agreeing with the lower levels of government (regional or local) where the services are to be delivered, service providers may either receive little support from lower levels of government or can be confronted with outright opposition.
- **Donors' insistence on maintaining established relationships and practices:** donors may resist harmonisation and alignment with government systems and continue with their own parallel initiatives which undermine the efficiency of government-led contracting out.
- **Unrealistic expectations:** contracting out may raise unrealistic expectations for service delivery. If expectations are not met, this may generate resentment among service users which could be channelled towards the government, the donor or the service provider.
- **Poor links between service provision and government:** when services are delivered by non-state actors, people do not realise that they are ultimately being provided by the government, which weakens their perception of the state's ability to meet their basic needs.
- **Services not aligned with some users' needs or preferences.** Service users may reject services if they consider the values of the service provider to be fundamentally misaligned with their own values or that their specific needs may not have been taken sufficiently into account.

Political risk is a significant challenge to the success of contracting out. Prevention is easier than cure; political risk is best avoided by thoroughly assessing the incentives of all key actors before deciding to contract out. However, the environment in a fragile state does not always allow for comprehensive assessments, particularly when either time or capacity constraints are acute. Moreover, these risks

evolve rapidly and may even have changed by the time they have been assessed. Even if the assessment is done well, some stakeholders' incentives may not be fully revealed until after a decision to contract out has been taken. In some instances, the way contracting out is designed and implemented will affect whether certain stakeholders see themselves as winners or losers, and whether they decide to support or obstruct the process. So even if a thorough risk assessment has been done at the start of the process, incentives will need to be systematically monitored over time to identify any changes in opinion or behaviour that could negatively affect the process.

>TIP: Prevention is easier than cure. To avoid contracting out failing, it is best to assess the likely political risks and the incentives of all key actors before deciding to contract out. These incentives need to continue to be monitored throughout the life of the contract too.

Reducing political risk

When political risk is evident either before or during the contracting out process, the government can reduce negative incentives and create positive ones through the following actions (and see Table 2.2):

- **Information sharing and policy dialogue:** explaining the concept of contracting out to stakeholders and providing examples of positive experiences in other places can encourage greater ownership and acceptance and also clarify the limitations of contracting out. This could occur through government meetings, public meetings, local consultation between service providers and end users, media debates and radio broadcasts. Information sharing and dialogue can continue after contracting out has begun to allow for open discussion of the reasons for any resistance by stakeholders.
- **Targeted efforts to improve incentives and reduce resistance:** examples include involving

lower levels of government in the management and oversight of the contracting out process; enabling government service delivery staff to work with or for third-party service providers; and matching types of service provider to local preferences.

- **Use of pilot initiatives:** this would involve initially contracting out services in a limited geographic area only. If successfully implemented and evaluated, pilot initiatives can demonstrate the feasibility of contracting out, thus building confidence amongst stakeholders and helping

to create support and overcome opposition (see Case Study 4 on Nigeria).

- **Appropriate contract design:** for example, to ensure that service recipients realise that services are delivered on behalf of the government, a service provider's contract should clearly specify that services are branded as government services.
- **Co-financing by government and donors:** joint financing by government and donors may increase their ownership and reduce the incentives for either side to pursue parallel processes.

Case Study 4. Pilot initiatives for contracting out health services in Nigeria

In 2006/07 a small-scale pilot to contract out health services was successfully developed and operated by the Metropolitan District Health Board in Enugu State, Nigeria. In the absence of a publicly-funded hospital in the metropolitan district, the District Health Board decided to subsidise a small number of private, faith-based hospitals to provide emergency obstetric care for women from the poorer, rural areas of the district. The aim was to test whether contracting with the private sector could work as a model for providing public services. There had been very limited previous work on public-private partnerships (PPPs) in Nigeria, and few attempts to integrate the public and private health sectors.

The scheme worked well, with nearly 50 women receiving emergency obstetric care during the first 12 months. The state government decided to continue funding the contracts in 2008, and to release the

funds directly to the district. Devolving responsibility for contracting out to the district was perceived as key to the success of this pilot case. The development of mutual understanding, good will and trust among the various parties was also important. The pilot demonstrated that contracting out can succeed in delivering “mainstream” government care. The approach could be used in other places where there are gaps in government services, or where government wants to expand services but lacks the physical or human resources to deliver.

Lessons learned: Small-scale practical examples of contracting out can provide government with some experience to build on. Devolving responsibility for contracting out to the government level responsible for implementation (in this case, the district level) may be important in ensuring trust is built between parties.

Source: PATHS (Partnerships for Transforming Health Systems) (2008), *Celebrating Success: PATHS in Nigeria (2002-2008)*, Department for International Development, London

Table 2.2. Some measures for reducing political risk

Measures...	...to prevent:
Expose stakeholders to concepts/experiences of contracting out to encourage greater ownership	<ul style="list-style-type: none"> • Limited government buy-in • Unrealistic stakeholder expectations • Resistance from lower levels of government
Targeted efforts to improve incentives	<ul style="list-style-type: none"> • Insufficient consensus within government • Resistance from lower levels of government • Rejection by recipients of the services provided
Use of pilot initiatives	<ul style="list-style-type: none"> • Insufficient consensus within government • Resistance from lower levels of government • Rejection by recipients of the services provided
Appropriate contract design	<ul style="list-style-type: none"> • Service not perceived as provided by government • Resistance from lower levels of government • Rejection by recipients of the services provided
Co-financing by government and donors	<ul style="list-style-type: none"> • Donor resistance to harmonisation • Limited government buy-in
Dialogue among key actors	<ul style="list-style-type: none"> • Insufficient consensus within government • Resistance from lower levels of government • Donor resistance to harmonisation • Rejection by recipients of the services provided

Technical risks

Like political risks, technical risks are a significant challenge to the success of contracting out. Technical risks arise when capacity or information, legal, procurement or regulatory systems are inadequate, or where markets operate imperfectly. The operating environment of a fragile state presents a significant number of such risks, including:

- **Lack of government capacity to identify contractual needs and manage the procurement process.** This includes a lack of government awareness of its role as a purchaser in the procurement process; inability to define contractual needs and hold contractors (and sometimes donors) to account for funds received or provided directly; lack of awareness of contracting risks and opportunities; and limited capacity for continuous risk monitoring during contract implementation.
- **Inadequacies in the enabling environment.** These may include inadequate legal frameworks and regulations with which to enforce contracts; limited enforcement or dispute-resolution capacity; absence of government policy frameworks to guide service delivery; and inadequate procurement and fiduciary systems to support the procurement process and ensure timely payment of contractual obligations.
- **Information gaps.** There may be insufficient information available on market conditions to support the contract design process, including service delivery costs, supplier capacity and availability, and provider and recipient expectations and behaviour. In addition, the government may lack the systems and skills to collect and analyse information on the fulfilment of the terms of contracts.
- **Lack of local suppliers capable of meeting contractual requirements.** The non-state sector may lack the necessary capacity to engage in contractual relations with government, or to supply goods and services on the scale required.

International contractors may not want to be involved given uncertainty about recovering costs incurred and whether they will make a profit. This may result in a lack of competition for contracts, or an escalation in contract prices.

- **Inappropriate system and contract design.** This includes procurement procedures and processes which do not match government and supplier capacity, and services and contract types which are too complex for a fragile environment.

Technical risks can potentially be reduced by developing the essential government capacities and systems for contracting out; ensuring appropriate contract selection and design; and technical support by donors and others (see Chapter 3). In addition, technical risks can be reduced if the services which are easier to contract out are done so first, thus allowing the government to gain contracting experience gradually.

Technical risks may not only undermine the successful implementation of contracting out, they can also give rise to political risks (Figure 2.1). For example, if procedures are considered inadequate to prevent the misuse of funds, donors may decide not to provide financial support for government-led contracting out and to bypass it altogether. If there are significant time delays in the procurement process due to procurement procedures and contract types which are poorly matched to the market, government support for contracting out may diminish and it may abandon it or start parallel initiatives. If citizens do not realise that non-state services are being provided on behalf of government, the government may cancel the contracting out process because it is perceived to be undermining its legitimacy.

The matrix in Figure 2.1 can broadly be interpreted as follows:

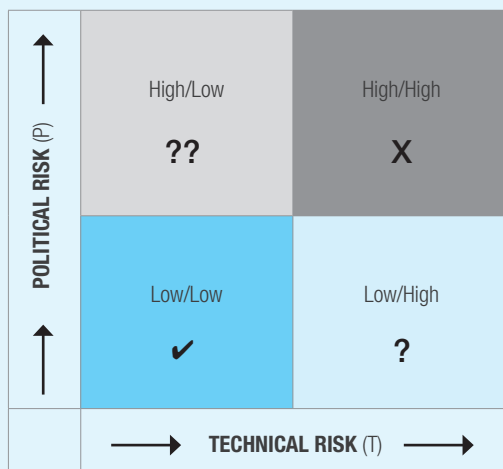
- **Low T/low P:** This is the ideal situation – both political and technical risks are assessed to be low. In this case, the government can move ahead with contracting out.
- **Low P/high T:** The next best scenario – political risks are low, even though technical risks are high; if the technical risks can be reduced through the design of government processes for contracting out, the government can still decide to contract out.
- **High P/low T:** Slightly more problematic – political risks are high, even though technical risks are low. This need not be an insurmountable barrier to contracting out if efforts are made to reduce the political risks. For example, the government could use a pilot initiative to demonstrate the effectiveness of contracting out, subsequently

reducing the political risks and enabling fuller implementation at a later date.

- **High T/high P:** Not conducive to contracting out – it is not advisable to proceed when both technical and political risks are high. Significant efforts are needed to reduce both types of risk.

These scenarios should not be considered static. A high P/low T scenario could successfully evolve into a low T/low P scenario over time, if initiatives by the advocates of contracting out shift the incentives from negative to positive and lower the political risks. Conversely, as already noted, failure to reduce technical risks adequately can increase the political risks. Thus a low P/high T scenario could evolve into a high T/high P scenario over time, significantly reducing the long-term success of the contracting out (see the **Southern Sudan** case studies 5, at right, and 9 in Chapter 4).

Figure 2.1. The interface between technical and political risk and the implications for contracting out



Case Study 5. Contracting a procurement agent in Southern Sudan

After 22 years of civil war, the entire public service in Southern Sudan had to be rebuilt from scratch. The Government of Southern Sudan had oil revenues but no public procurement system. In 2005, a Joint Assessment Mission comprising donor and national partners recommended that core fiduciary services should be contracted out to international firms until government capacity was built.

The Ministry of Finance & Economic Planning agreed with donors to contract a procurement agent to carry out all procurement on behalf of the Government of Southern Sudan. This included Multi-Donor Trust Fund (MDTF) procurement financed jointly by donors and government; and procurement funded directly through the government budget, in turn financed by the government's substantial oil revenues.

A competitive procurement process was launched using World Bank procedures. However, they proved complex for the Ministry of Finance to manage, and the process took over a year to complete. In the meantime, MDTF procurements experienced significant delays, while government line ministries started to procure items themselves, despite lacking procure-

ment capacity. Due to its own capacity constraints and the lack of a viable alternative, the Ministry of Finance was unable to prevent them from doing so.

By the time the procurement agent was in place, the Ministry of Finance was unable to reassert a centralised procurement system over line ministries for purchasing items approved in the budget. Line ministries continued to manage these procurements directly despite their limited procurement capacity and with frequent disregard for procurement procedures. They frequently awarded contracts which exceeded the available funds, and the government built up a substantial stock of unfunded contractual obligations. The procurement agent's role effectively became limited to donor-funded MDTF procurements only.

Lessons learned: failure to reduce a technical risk (a procurement process which was ill-matched to the urgency of the situation and to government capacity, leading to contracting delays) undermined the political ability of the Ministry of Finance to impose a centralised procurement system on line ministries. This in turn prevented sound public financial management.

Source: Davies, F. (2009), "Contracting out Government Functions and Services in Southern Sudan", in OECD (2009), *Contracting Out Government Functions and Services*, OECD, Paris

References

OECD (2008), *Service Delivery in Fragile Situations: Key Concepts, Findings and Lessons*, DAC Fragile States Group, OECD, Paris.

Useful resources

Resource centres

1. The Policy Practice

www.thepolicypractice.com

The Policy Practice holds an extensive range of resources on political economy analysis on their website, including a recently launched online library on tools and applications of political economy analysis.

2. OECD DAC GOVNET

<http://oecd.org/dac/governance/politicaconomy>

The DAC network on governance (GOVNET) web page on political economy analysis.

3. World Bank

<http://go.worldbank.org/MT5JIN7GK0>

The World Bank's web page on the political economy of reform.

4. Power and Politics in Africa Research Programme

www.institutions-africa.org/page/home

The Power and Politics in Africa Research Programme identifies approaches to exercising power, doing politics and building states for development and poverty reduction in sub-Saharan Africa.

2. World Bank, 2007, 'Tools for Institutional, Political, and Social Analysis of Policy Reform: A Sourcebook for Development Practitioners', World Bank, Washington D.C.

http://siteresources.worldbank.org/EXTTOPPSISOU/Resources/1424002-1185304794278/TIPs_Sourcebook_English.pdf

A framework and tools for assessing the impacts of policies on different social groups.

3. Unsworth, S., and Conflict Research Unit, 2007, 'Framework for Strategic Governance And Corruption Analysis: Designing Strategic Responses Towards Good Governance', Netherlands Institute of International Relations, Clingendael, The Hague

www.clingendael.nl/publications/2007/20071000_cru_occ_unsworth.pdf

This document provides a framework for undertaking a rapid assessment of government, state-society relationships and key actors' capacities and interests.

4. GSDRC Political Economy analysis topic guide

www.gsdr.org/go/topic-guides/political-economy-analysis

This topic guide provides pointers to some of the key literature on donor approaches to political economy analysis and its effectiveness in different contexts. It includes examples of analyses and tools applied at country, sector and programme levels.

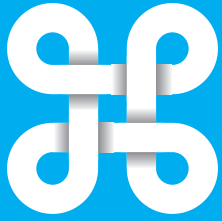
Other resources

The following sources set out ways of assessing the interests, incentives and capacities of actors involved in the delivery of a government function or service.

1. DFID, 2009, 'Political Economy Analysis 'How to' Note', A Practice Paper, Department for International Development, London

www.gsdr.org/docs/open/PO58.pdf

An overview of political economy analysis, its application and benefits including case studies on how political economy analysis can be used.



Chapter 3

Contracting out and capacity development

What's in this chapter?

Chapter 2 has looked at some of the political and technical factors that need to be understood *before* deciding whether or not to contract out. This chapter now turns to two issues at the heart of the challenge: (1) how to contract out in fragile states where government capacity is weak; and (2) how to ensure that contracting out develops capacity rather than undermining it further. The chapter explains:

- > Why governments need capacity for contracting out and what we mean by “capacity”.
- > How to deal with very weak capacity.
- > How to assess and build the capacity needed to contract out functions.
- > How to develop government capacity to reassume these functions, either as a part of or in parallel to the contracting out process.

Key lessons learned

- > Fragile states should evaluate whether they have adequate laws, administrative structure and regulatory capacity to contract out services. If they do not, the government should consider temporary solutions to help bridge these gaps, enabling contracting out to proceed.
- > Contracting out is not a replacement for internal and country-led capacity development. The use of contracted service providers can fill the immediate capacity gaps facing a country, but a broader capacity development strategy is needed to manage the transition from dependence on external resources to long-term sustainability.
- > Failure to develop government capacity to assume responsibility for the delivery of services, whether as regulator/facilitator or as direct provider, may eventually undermine the legitimacy of the state in the eyes of its population and diminish its accountability towards its citizens. Therefore, government and donor partners need to agree a clear capacity development strategy at the start of the contracting out process.

3.1. Why does contracting out require capacity?

Contracting out is a complex undertaking; to be successful it requires both government and non-state actors to possess specific capacities (Box 3.1). In fragile states these capacities are often lacking. Unless capacity for contracting out is adequately addressed, one of two sub-optimal situations could arise:

- 1) Governments proceed with contracting out while lacking adequate capacity to manage the process, either leading to badly-specified contracts or long delays in contracting.
- 2) Governments do not contract out at all, as the capacity requirements for managing the process seem overwhelming, even though, if managed properly, contracting out would offer the best solution to meeting service delivery and/or capacity needs.

In addition, as discussed in Chapter 2, one of the incentives for contracting out in fragile states is that the government may lack the internal capacity to

carry out core functions and deliver basic services to meet the urgent needs of its population. However, contracting out certain functions and services to third parties is not a replacement for internal government capacity development. Failure to develop internal capacity constitutes a long-term risk for government, and could potentially lead to unsustainable dependency on contracting out.

Governments face a number of risks if they fail to build their internal capacity to either resume responsibility for the contracted-out function in the long run, or else to manage and monitor outsourcing successfully without external support:

- **Limited or no government capacity to manage the contracting out process** sustainably over time. The success of contracting out is continuously dependent on external support, either in the form of technical assistance or contracted advisory and evaluation services.

Box 3.1. Capacity defined

In a general sense, capacity includes the skills and aptitudes, resources, relationships, and facilitating conditions necessary to effectively achieve an intended purpose. As described in Chapter 1, these components can be thought of as operating at three levels: the individual, the organisational, and the enabling environment (see Figure 1.1).

Each of these levels of capacity is interconnected and interdependent. Individuals need the right skills, knowledge and experience to carry out tasks effectively, but they can only use these to accomplish tasks when they work in an organisational structure (formal or informal) that provides them with sufficient resources and incentives. In turn, organisations do not operate in a vacuum; they

themselves are influenced by an external context that constrains or facilitates their capacity to function effectively. This facilitative context is called the enabling environment when positive factors allow and encourage both individuals and organisations to perform and achieve results. Capacity development can help to strengthen the government's ability to perform its role in a fragile state and improve the state-citizen relationship by demonstrating government competence (OECD, 2009). Countries in fragile and post-conflict situations usually have capacity gaps at all three levels. Because of the linkages among the levels, efforts to strengthen one level without paying attention to the other two generally lead to limited and/or unsustainable results (see Brinkerhoff, 2010).

- **Limited or no government capacity to assume responsibility for the service or function** once the contract ends. Contracts therefore have to be extended, generating further dependency on donors and third-party contractors to support the functions of the state.
- **Limited or diminished government ownership** of its functions, thus further reducing its incentive to develop internal capacity.
- **Limited accountability towards citizens** given the lack of oversight and ability to co-ordinate what is delivered to them.
- **Failure to include provisions for capacity development** or hand-back within the scope of contract.

In order to ensure sustainability and design credible

exit strategies – either from external support for contracting out or from contracting out itself – **decisions on how to develop internal capacity need to be taken alongside the decision to contract out.**

The next section (3.2) explores how to assess whether a government has the capacity to manage the contracting out process. If this assessment reveals that government capacity is too weak to manage contracting out initially, then procurement agents can be used to fill the capacity gap in the short-term (Section 3.3). Section 3.4 then summarises some approaches for building government internal capacity as part of the contracting out process.

>TIP: A state should decide how to develop its capacity at the same time as deciding to contract out, rather than postponing it until later.

3.2. Assessing the capacity needed for contracting out

It is important for the government to assess its capacity levels for contracting out before embarking on the contracting out process. This section offers a guide to assessing capacity for contracting out at the three levels described in Box 3.1 (the enabling environment, organisational arrangements and individual leadership) using a series of decision trees.¹

Assessing the enabling environment

In a fragile state, a key initial step in contracting out services or government functions is to assess whether the environment for contracting out is enabling (Figure 3.1). To a large extent this can be conducted as a one-off process and need not occur on an ongoing basis. However, subsequent procurements which contemplate new contract types or

provisions may require the enabling environment to be evaluated again for these new aspects.

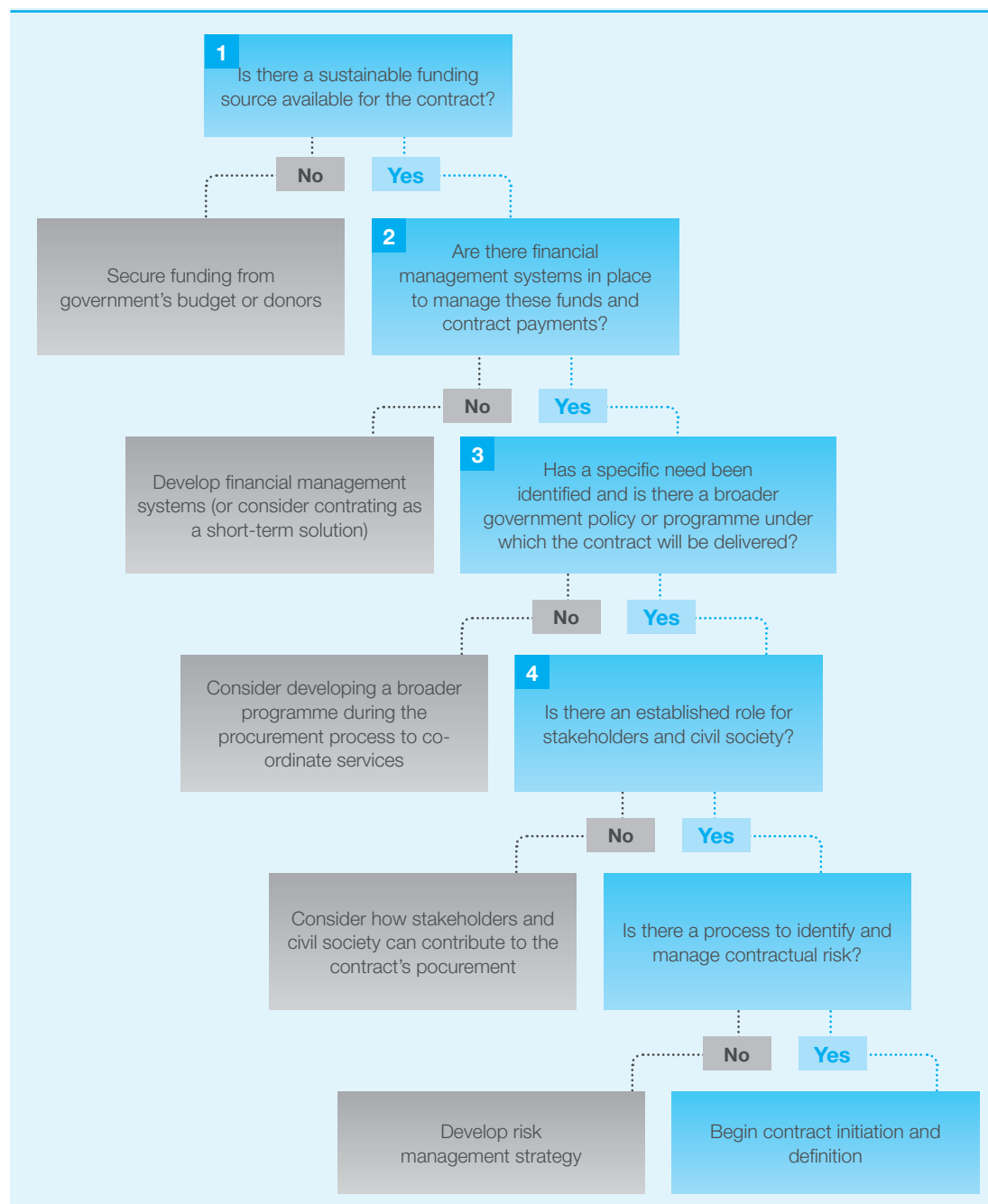
The procurement process is ideally carried out within an enabling environment that establishes legal, regulatory and policy parameters for government as well as for potential bidders. A solid enabling environment will help the government manage the procurement process, achieve the goals and objectives of the procurement, and obtain the best value for money. If the environment is not fully supportive of contracting out, as is frequently the case in fragile states, additional measures can be introduced as safeguards until the broader framework is established. These are discussed later in this chapter.

The enabling environment for contracting out includes:

- The legal framework; and
- The regulatory and policy framework.

¹ However, these decision tree diagrams cannot capture all the factors that each government should consider in contracting out, many of which are unique to individual governments.

Figure 3.1. Decision tree: readiness to contract



The enabling environment also includes the human resources management capacity needed to support contracting out. Without all these, it is difficult for the government to establish an effective procurement system that will assure service delivery, provide the state and citizens with the best qualified contractors, assure the best value while maintaining cost controls, and gain the confidence of contractors. Of course, in fragile situations, this ideal situation is unlikely; governments should instead aim for what is “good enough” in the circumstances.

The legal framework

Ideally, a country will have a legal framework comprised of a number of laws that enable contractors to provide government services. These laws include: anti-corruption laws; specific laws governing the contracting out of government services; and laws and regulations on procurement, contracts and obligations, enforcing a judgement, standards, business organisations and NGOs, trade, property, technological transfers, protecting private information, and finance and financial institutions (see also Box 5.1 in Chapter 5). These statutes should:

- establish the authorities under which procurement can be carried out;
- outline the types of contracts that can be executed; and
- ensure transparency, fairness, competition and accountability in the procurement process.

Transparency helps to build confidence and trust between the government, the community and suppliers. Competition is important for driving suppliers to offer tenders that provide good value and sound technical solutions at competitive prices. Accountability is critical to ensuring fairness in the procurement process, so that the intended results of the contract are achieved. In a fragile state these attributes may not be present.

The decision tree in Figure 3.2 can be used to assess the legal environment and take steps to improve it.

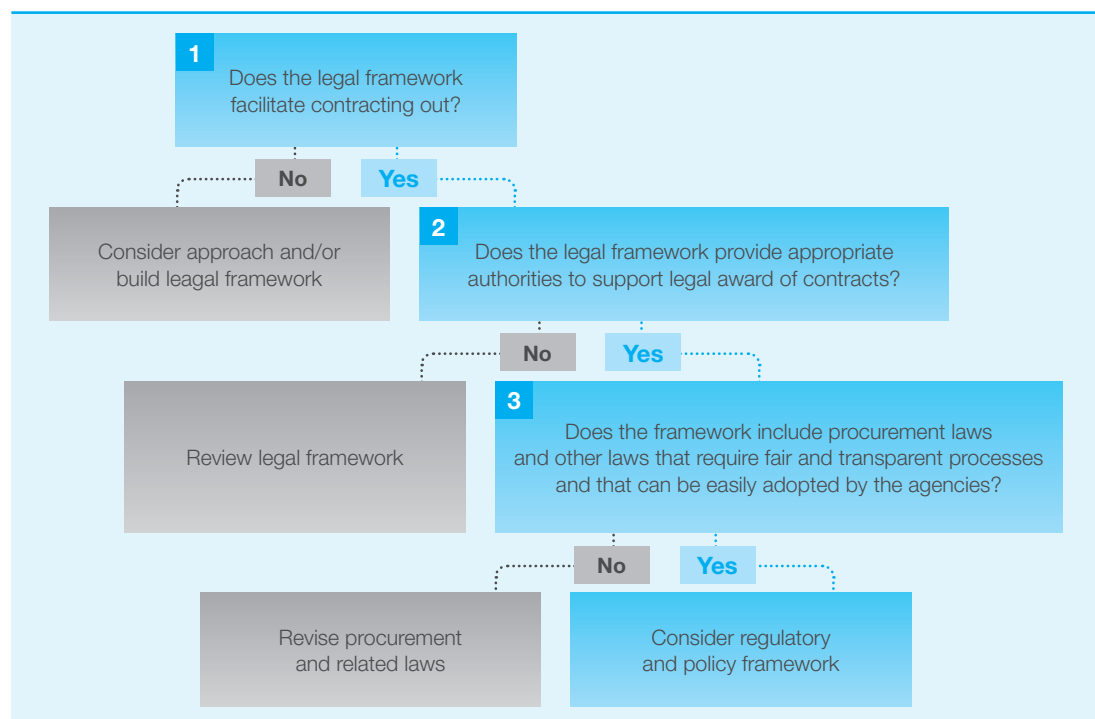
Where deficiencies are identified the legal framework should be revised. However, short-term options may be available that can adequately address the limitations or risks while the legal framework is being improved. Steps should then be taken to develop the basic elements of the legal framework so as to provide some guidance for conducting the procurement process (the principles of the design of a legal framework are discussed in Chapter 5). This could be developed by an *ad hoc* group which is familiar with the law, or which has access to technical assistance.

If there are no laws governing contracts for providing government services, the contract itself needs to be prescriptive enough to supply the missing terms. These terms should be consistent with national legal tradition and culture since they are in a sense substituting for a national law. Alternatively, the terms could be based on the laws of another country in the region or other major trading partner. In fact, the contract could state that it should be interpreted under the laws of another country.

>TIP: In fragile states many contracted services are urgently needed. While legal and regulatory directives often require that detailed procurement processes are followed, laws and regulations can also provide the flexibility to use abbreviated procedures when there is a compelling justification, such as an emergency requirement for services (e.g. to restore essential health and education services to the population after a conflict).

Regulatory and policy framework

The regulatory and policy framework provides specific guidance and procedures for implementing the statutory requirements of the legal framework (Box 3.2). It can also define the key tasks of the procurement process, guide the actions of government officials and assist in implementing a reliable and efficient process.

Figure 3.2. Decision tree: legal framework

A country's procurement policy provides guidance on how the legal and regulatory frameworks can be applied to the actions and decision-making process of government policy makers. It is important that procurement policies provide practical guidance to policy makers. This includes establishing protocols and procedures for managing, designing, tendering and implementing the contracts in accordance with legal and regulatory requirements (see Chapters 4 and 5). Inadequate or out-of-date policies can often lead policy makers to take actions that are inconsistent with the legal and regulatory frameworks, which may result in a significant waste of time and resources, particularly if further actions are required to rectify these errors. The tendering process may be delayed or cancelled and, if the contract has been awarded, it may be deemed illegal or unenforceable and subsequently be cancelled.

In addition to containing specific procurement regulations, the government's broader policy framework may also define the role and functions of a monitoring body to oversee the contract. Contract monitoring is typically performed by the agency with the technical responsibility for the services being procured. Monitoring entails evaluating the services provided under a given contract to ensure they comply with the contract terms. For certain types of services, such as water or electricity, contract evaluation may be performed by a regulatory agency, which has a broader sectoral responsibility for service planning and delivery. As discussed in Chapter 5, the contract should include specific provisions establishing the regulator's authority. If the regulator does not have sufficient capacity to regulate and oversee the contract, this capacity should be developed. Capacity development can be included in the contract for services or in a separate agreement with the contractor or third party (see Section 3.4).

Box 3.2. An enabling regulatory and policy environment for contracting out government services

The government needs the following supportive administrative and regulatory structure:

- **An independent regulatory body with authority within government.** Its responsibilities should be spelled out in laws and regulations. Key functions, including advice to contracting entities, monitoring procurement, managing procurement information and statistics, and supporting capacity development, can be done by a centralised agency or assigned to different agencies.
- **Procurement planning and budgeting capacity.** Procurement plans should be based on the outputs and outcomes that government agencies need to achieve in a particular period, see Chapters 1 and 4. These plans in turn drive budget decisions. These plans should be periodically updated so that budgets can be properly planned and managed. Procurement actions should not be initiated unless funds have been allocated to the procurement.
- **Institutional development capacity** to support and monitor the performance of the procurement system. To achieve the necessary capacity, a country must have a sustainable training programme, as well as quality control standards that are disseminated and used to evaluate staff performance. It should also have a system to provide staff and others with up-to-date information on contracts as well as statistics on procurements and contracts.
- **Procurement operations** which are of a sufficient quality to make procurements efficient. This includes proper management in the agencies dealing with procurement and ability to comply with procedures for inspection, quality control and monitoring. Government officials with procurement responsibilities should have the necessary skills. Procurement procedures and record keeping requirements must be complied with.
- **Private sector capacity to respond to public procurement.** Private sector ability to participate in procurements and provide services should be examined carefully. If private businesses lack the capacity an international tender will be necessary. Capacity includes a range of firms with expertise, management abilities, and access to credit. In addition, there should be effective mechanisms for public-private partnerships (PPPs), such as dialogue and a legal framework for PPPs.
- **Control and audit systems,** which include a framework for internal and external control and audit of public procurement operations, a system and auditors that can ensure quality audits, and follow up and enforcement on findings and recommendations from audits.
- **Measures to prevent and detect fraud and corruption,** which should include all stakeholders in the procurement system. Procurement authorities must be responsible for running and monitoring a transparent and efficient system. The organisations with audit authority and legislative oversight must be responsible for detecting and addressing irregularities or corruption. The private sector should have a secure mechanism to report fraudulent, corrupt or unethical behaviour.
- **An appeals mechanism** that provides for transparent decision-making and efficient and fair review and ruling by an independent body with enforcement authority and capacity. Decisions should be published and made available to all interested parties and to the public.
- **Mechanisms for dispute resolution** (see Chapter 5).

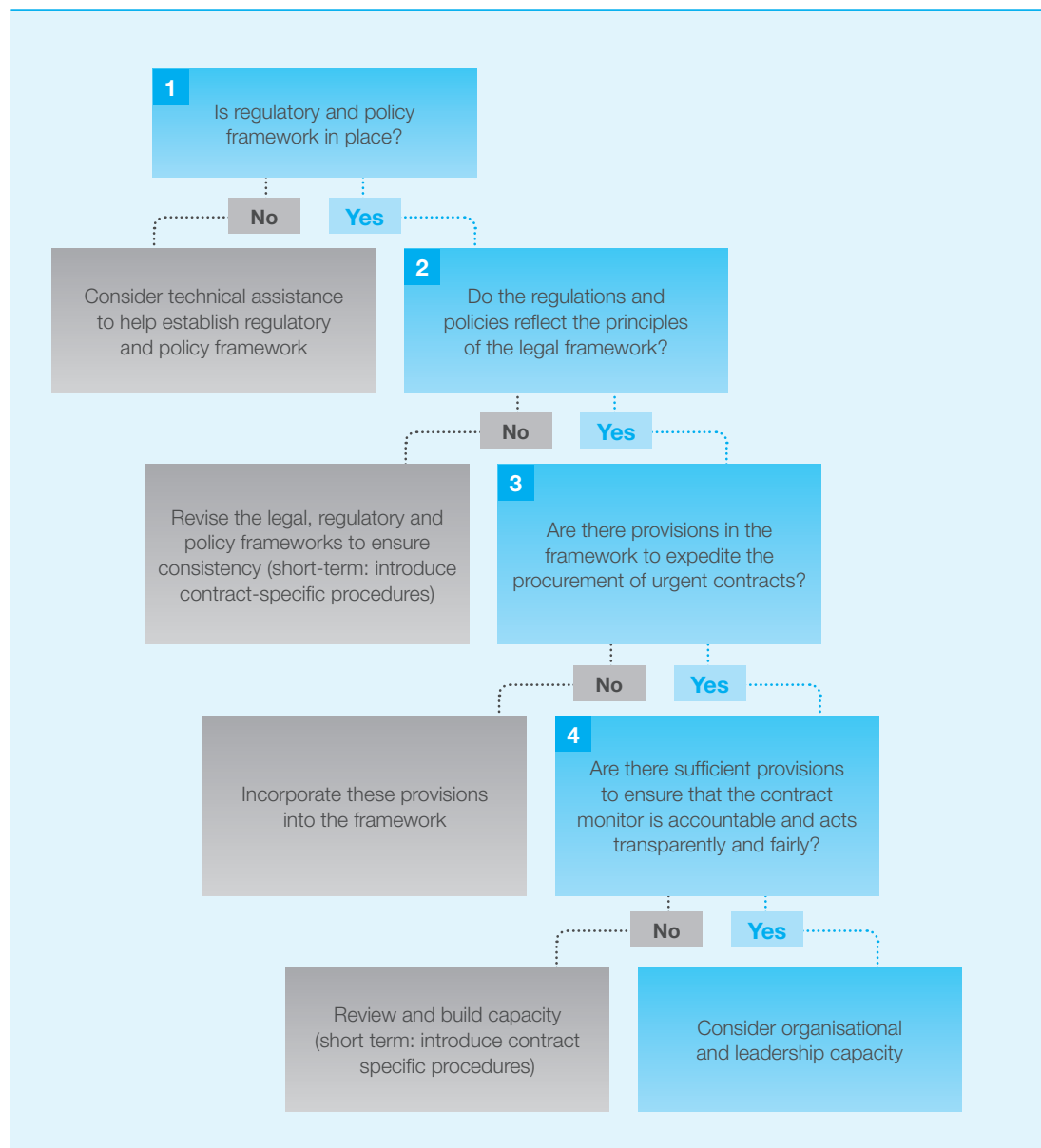
Figure 3.3. Decision tree: regulatory and policy framework

Figure 3.3 outlines the steps to be taken in deciding what elements are needed to create an enabling regulatory and policy framework.

> **TIP:** In fragile situations, the legal, regulatory and policy frameworks may be incomplete. Establishing an appropriate framework should be a national long-term objective, but clarity in the short term may be obtained by incorporating provisions in the contract that might otherwise be guaranteed by the legal framework.

Assessing organisational capacity

A government's capacity determines its ability to carry out the procurement process and can therefore have a significant impact on the contract's outcomes. An assessment of organisational capacity needs to find out whether government agencies and staff understand the legal, regulatory, and policy frameworks, and are organised to apply them to the procurement process. The assessment should also look at the roles of different government agencies to determine whether there are procedures, leaders, and staff to guide the procurement process and apply the legal and regulatory frameworks (Figure 3.3).

At the organisational level, a government needs to be able to:

- Assess the desirability and requirements for contracting out, including costs and benefits, and opportunities and risks.
- Design contracts, including specifying the scope of work, price estimation, payment terms, performance criteria, and benchmarks for monitoring (Chapter 4).
- Manage the contract, including setting up and successfully executing tenders, contract administration, and financial payment systems and procedures.
- Monitor and evaluate the contract, and should possess accountability and enforcement systems, and dispute resolution techniques (Chapter 5).

Implicit in all of these is that systems, processes and procedures should be sufficient to manage the risks of corruption throughout the contracting and contract management process.

This assessment provides the structure within which the procurement planning can take place and has a significant influence on the procurement design process, the timeline for initiating and completing actions and the ability to collaborate on design and implementation activities. Typically, this process involves a number of government agencies, in each of which capacity is important (Table 3.1). The government's capacity to support bodies such as central agencies or procurement agencies determines their ability to fulfil their role as supporting agencies in the procurement process. There is a variety of organisational capacity assessment tools that can be applied to analysis for contracting out (*e.g.* see Lusthaus *et al.*, 2002).

Technical assistance can be helpful in identifying any gaps in organisational capacity for procurement and recommending strategies for capacity development. In fragile states, contracting out itself can help develop new institutional capacities within government. Government needs to be concerned both with developing the immediate capacities of local organisations to provide services, and with the development of the government's service delivery capacity in the longer term. It is often difficult for government to address these issues when services are required urgently or when contracts are procured on an *ad hoc* basis. However, it is easier for governments to balance their immediate and long term needs when there is clarity about their programme strategy.

The assessment of organisational capacity should include the government's financial systems and whether they are adequate to ensure availability of funds, allocate funds and make payments consistent with contractual requirements.

Figure 3.4. Decision tree: organisational capacity

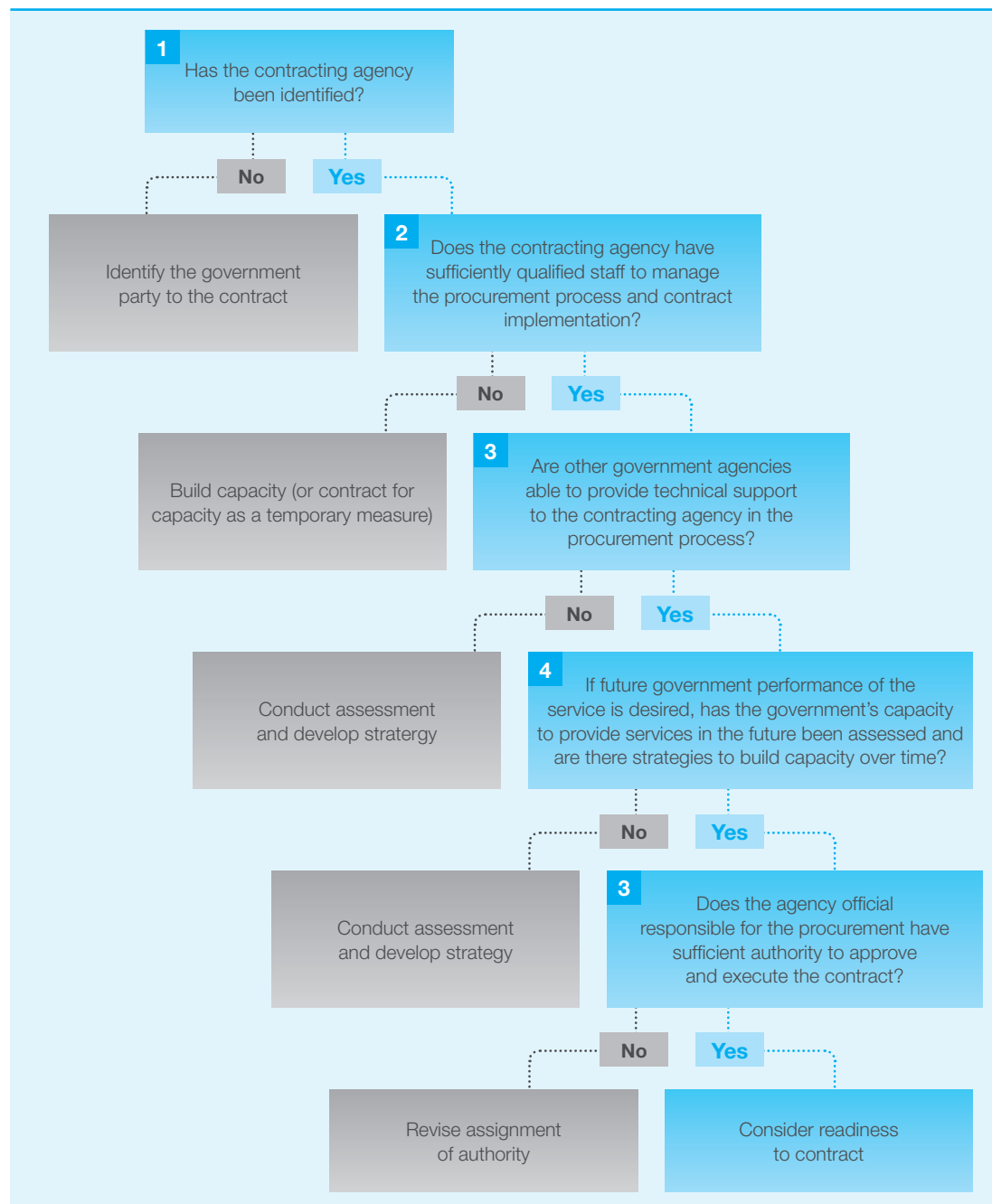


Table 3.1. Typical roles for assessing the enabling environment

Role	Responsibility
Procurement policy or <i>ad hoc</i> team	<p>Technical: The assessment would typically be conducted for the whole of government. Often this is led by a procurement policy team (if it exists), which would be located in a central government ministry (<i>e.g.</i> Ministry of Finance). If there is no procurement policy function, an <i>ad hoc</i> team could be established to perform the initial assessment with technical assistance. The team should include a legal adviser. The analysis should include an assessment of the procurement capacity of different entities in government.</p> <p>Institutional: The assessment would typically be conducted for the whole of government. An <i>ad hoc</i> team could be established or alternatively linked with a civil service or public sector review process if one has already been initiated. Often external technical assistance is used to help develop the review framework and conduct the reviews.</p>
Government, cabinet and/ or council of ministers	<p>Political: There should be political endorsement of the assessment and agreement on steps to address identified constraints, such as popular resistance to the idea of contracted services. Reviews of leadership capacity are likely to be politically sensitive, and therefore may need to be conducted internally.</p>

Preferably, assessment should be government-wide (Table 3.1) because this is more cost-effective than launching an in-depth analysis each time procurement is contemplated. However, in an urgent situation an assessment can be done for a specific procurement. Until procurement practices are firmly established and mature, some degree of assessment will be required each time a new procurement process is proposed.

For the non-state sector, service suppliers need the following capacities:

- Ability to supply goods and services on the scale required.
- Management systems that meet contract law requirements.
- Ability to prepare tenders and engage in contractual negotiations with government.

Urgent requirements in fragile situations often cannot wait until all of the organisational and environmental weaknesses have been addressed, particularly as good technical capacity is required for most if not all significant contracting out processes. The Afghanistan experience (Case Study 6)

and Section 3.4 below demonstrate how contracting out for additional procurement capacity can provide a short-term solution to this problem, allowing critical contracting requirements to be addressed whilst capacity-building is underway.

Assessing individual capacity

At the individual level, two types of capacity are required: (1) political and leadership capabilities; and (2) technical skills and experience. In the political and leadership category, a government needs champions who can provide vision, anticipate and address obstacles, and build support for contracting out (Box 3.3). Such capacities can be a critical component in building incentives, creating effective organisational capacities and contributing to a positive enabling environment. Where contracts are large, highly visible or possibly controversial, political champions have proven to be critical to gaining support for contracting out. In fragile settings confidence and trust in government is often low. Convincing citizens and potential suppliers that the state is committed to quality service delivery and efficient and honest contract management can be an important step in rebuilding a functioning government and positive state-society relations.

One element of capacity assessment includes examining the number, qualifications, skill levels, availability, and distribution of staff capable of undertaking the various tasks associated with contracting out. Clearly, without appropriately qualified people willing and able to take on these tasks, neither the government nor potential service contractors will be in a position to successfully pursue contracting out. Stakeholder analysis can be helpful to map the range of interests associated with contracting out for services, and to determine where there might be champions supportive of contracting out.²

2. The UK's Overseas Development Institute provides additional information on stakeholder analysis at www.odi.org.uk/Rapid/Tools/Toolkits/Communication/Stakeholder_analysis.html

Individual technical capacities include competent professionals, such as lawyers, accountants, and financial managers, all of whom are needed to manage the procurement process and contract administration. Individuals with technical knowledge of, and experience in, the sectoral services that are to be contracted out (for example, health, education, municipal services) are needed by government in order to design contracts effectively and exercise appropriate oversight and quality control. Such individuals are also necessary for non-state suppliers.

Box 3.3. Contracting out champions: pros and cons

Capacity at the leadership level of government is an important consideration particularly for contracts that are large, highly visible or controversial in some respect. A champion at the leadership level who can provide vision, anticipate and address political obstacles and build support for contracting out can be a critical component in creating an effective enabling environment. Concerns may be encountered from other ministers, other

government institutions or bodies, local community representatives or other stakeholders. Strong leadership can address these concerns so that they do not obstruct the procurement process and delay the delivery of critical services. On the down side, relying solely on a leader can make procurement overly dependent on a single individual retaining their post, or politicise a programme which is not inherently political in nature.

3.3. Contracting out when capacity is almost non-existent: the use of procurement agents

Where an assessment reveals the enabling environment to be especially weak, the government can contract out the procurement function itself; for example, in **Afghanistan** a centralised procurement agent was set up through a contract (see Case Study 6). The procurement agent acts on behalf of the government to manage the acquisition of services and products. Typically the agent will manage all aspects of one or

more procurements and will charge a fee for its services. A procurement agent is usually a firm that specialises in purchasing goods and services. Normally, the procurement agent would follow the procedures set out in the country's own laws and regulations, but in some cases procedures may be determined by donors. In the latter case, it is even more important to have a procurement agent to manage donor requirements.

Case Study 6. A centralised procurement agent in Afghanistan

When the interim Afghan administration took power in 2002, Afghanistan's physical, human, institutional, and social capital had been decimated by 30 years of conflict. In recognition of the weak legal, regulatory and organisational capacity, the Afghanistan Reconstruction and Development Services (ARDS) was established in December 2003 with an outsourced procurement agent. The ARDS operated as a government body to put in place emergency procurement capacity to allow for the rapid and transparent use of donor resources for reconstruction and development.

Its primary task was to assist line ministries to carrying out procurement following the guidelines of funding entities for all goods, works and services financed directly under donor and government-funded contracts. Consequently it complied with either donor requirements or government procurement legal requirements, depending on the funding source. This created a centralised procurement system, with the ARDS as the sole body providing procurement services.

Performance under this arrangement was reasonable. Procurement was competitive, giving adequate

timing to prepare and evaluate bids, and ensuring transparency in the advertisement of bids and publication of awards. However, the overall performance of this mechanism was constrained by the limited capacity of line ministries to prepare all the necessary documents, as well as sometimes by delays in obtaining required approvals. The volume of procurement managed by the ARDS also at times resulted in delays of around four months, with another two or three months spent on technical and financial assessment, shipment and mobilisation. Private sector participation was limited, with typically less than five bids per offer.

A separate Procurement Policy Unit was established in the Ministry of Finance to develop procurement policy and improve the government's capacity to manage procurement processes. Consequently, over time there has been a gradual increase in procurement managed directly by ministries.

Lessons learned: The role of the procuring agency itself can be contracted out as a short-term solution when procurement capacity is lacking. Where this is done, it should be part of a longer-term strategy to build the public sector capacity.

Source: "Case Study Presentation", African Development Bank (AfDB)-OECD joint conference on Contracting Out Core Government Services and Functions in Post-Conflict and Fragile Situations, Tunis, June 2009

The process for contracting out the procurement function is similar to that for contracting out other government services (Chapter 4). When choosing a procurement agent, the government should evaluate bidders' expertise in procurement and experience in writing specifications and procurement documents in the particular sector. The government should try to obtain proposals from agents who deal regularly with contractors in the specific sector of government services (health, infrastructure, etc.). Procurement agents should also have

lengthy experience, and should have a track record of procurements and a reputation for honesty and competence. The government should also check the training and experience of agency personnel, the agent's contract and performance history, licensing and registration, and references. These steps can be undertaken with assistance from donors when necessary.

>TIP: A procurement agent can be an effective approach to managing complexity where donor

procurement requirements need to be followed because the contract will be funded by a donor.

The relationship between the government and its procurement agent should be set out in a detailed contract for procurement assistance. The contract should be in writing and signed by both parties. The contract should contain the terms necessary in all contracts between the government and contractors (see Chapter 5: “Drafting contracts: some guidance”). In addition, the government should consider some specific terms of contracts for procurement assistance:

- **Scope of work:** The contract must set out in detail the work to be performed by the procurement agent. The contract should establish the extent of procurement work to be undertaken by the agent (by time, project or some other measure) and what types of services will be required. If the contract specifies milestones and deliverables that must be met, it may be easier to shift performance and cost risks to the procurement agent. The scope of work should also establish that the procurement agent shall purchase services and goods as economically as possible consistent with the requirements of the project. The government may wish to refer to external benchmarks – such as international market prices for commodities – for assessing the procurement agent’s work and ensuring that the procurement agent is achieving best value.
- **Price:** Methods for pricing procurement services include a percentage fee based on the value of the purchases, and a fixed price. A percentage fee may be the best alternative when the volume and price of procurements are unclear; on the other hand, a percentage fee creates a moral hazard, for in effect it creates incentives for the procurement agent to spend more. Procurement fees typically range from five to ten percent of the funds handled. Alternatively, a fixed price can be used when the requirements can be stated with reasonable accuracy at the time of contracting, *i.e.*, when the list of goods and/or services is clear. A fixed price contract gives the procurement agent an incentive for efficiency

and allows the government to know with some certainty how much must be allocated to cover the services. A change orders clause in the contract provides for adjustment of the fixed price should the work requirements change substantially.

- **Duration:** The duration of the contract can be defined in terms of time (the length of the procurement agent assignment) and/or quantity (the goods or services to be procured).
- **Approvals:** The contract should clearly specify the necessary approvals for procurement processes and contracts between the government and contractors, as well as the procedures for obtaining for approvals.
- **Conflict of interest:** It is important to ensure that the procurement agent does not have a conflict of interest. This includes the procurement agent firm not having any relationships with bidders and separating its activities as a procurement agent from any activities that it may carry out as a supplier of goods or services. The government may ask the procurement agent to disclose any potential conflicts of interest at the outset of the relationship, and to report any new potential conflicts that arise after contract award. The government should not abdicate its responsibility for monitoring potential conflicts of interest; it may, however, wish to require the procurement agent to facilitate the monitoring function.
- **Payment:** The contract should specify the procedures and mechanisms to be used to obtain payments for the services or goods.

It is important that the government closely monitor the procurement agent’s performance. This requires the government to have the ability to ensure that the agent is conducting proper procurement processes in compliance with the law, is getting competitive prices, and services and products are of high quality and are being delivered in compliance with the terms of contracts.

The disadvantages of procurement agents

The use of procurement agents does, however, bring a measure of risk. Procurements run by agents are often, for practical reasons, less transparent and less subject to review. Private procurement agents may be largely immune from the judicial or political oversight that normally applies to every official action. It may, therefore, be harder to trace corruption or inefficiency if they do emerge in privately-run procurement actions. Private procurement agents also may be exempt from the personal conflict of interest rules that normally govern public officials. Similarly, because the private procurement firms are involved in so many stages of the procurement process, the firms may shape requirements and then participate in procurements for those requirements – and thus may

trigger organisational conflicts of interest. Finally, and most fundamentally, because the procurement agents almost always come from outside the nation that retains them, the agents may be less sensitive to local social and political norms, and may be less engaged in the nation's shared goals.

Using a procurement agent can set back a government's efforts to develop its own capacity to procure goods and services. However, procurement agents can also help countries develop capacity for doing their own procurement in the future if capacity building is included in the contract with the procurement agent (Case Study 7). There are different capacities that need to be developed: design, evaluation, competition, negotiation, management and oversight. Including capacity development in a contract is discussed in detail below.

Case Study 7. Liberia's Governance and Economic Management Programme

The Liberian Governance and Economic Management Assistance Programme (GEMAP) was established in 2005 to address the challenges that the Liberian Government was facing in generating revenues and controlling public expenditures during the post-conflict period. GEMAP is a partnership between the international community and Liberian Government and it helps to provide internationally-recruited advisors who are posted in the financial offices of several key Liberian government institutions. The advisors have a mandate to establish transparent financial management systems, build the capacity of Liberian staff, and ensure open reporting on operations, revenue and spending. One area of focus is to improve procurement and concession practices.

GEMAP has developed several indicators for capacity building. These range from output indicators on number of days of training for staff to impact indicators on job performance. It appears that while

the programme has been successful in many ways, skills transfers from advisors to Liberian staff have not met expectations. Skills transfer through on-the-job training is a particular challenge. This is a fairly common problem and may reflect the difficulty that procurement agents and other contractors have in taking on an unfamiliar role of training staff from a different culture while fulfilling their professional duties for the government.

Lessons learned: A combination of classroom and on-the-job training is needed to develop government capacity. The training should be designed and implemented as a programme that is additional to the services being provided to the government. This capacity-building programme should use specialised training expertise and should be measured by separate indicators. Host country staff should have incentives to learn and take responsibilities from their advisors, e.g. potential promotions and pay increases.

>**TIP:** In a fragile state, a procurement agent can quickly bring in staff and systems that will allow the government to contract out services rapidly. However, laws and procurement rules still need to be in place so that procurements aren't delayed by the procurement agent's lack of legal authority and procedures. Laws and procurement rules need to provide for efficiency, so that services can be procured quickly, especially where there

is critical need after a natural disaster or conflict. They also need to provide for transparency and oversight. An alternative is to use donor procurement rules, and in fact some donors encourage the use of procurement agents and will even contract for the procurement services. But this should be a temporary remedy and the country's legal infrastructure should be developed as quickly as possible.

3.4. Dealing with weak capacity: from dependency to long-term sustainability

The results of the enabling environment, organisational and leadership capacity assessments described above will feed into an evaluation of a state's broader capacity development needs. Contracting out can be used as a tool both for a third party to provide services and for government to develop its own capacities. These functions can be contracted for separately, or capacity development can be built into the same contracts that provide for short to medium-term service delivery.

Thus, decisions on how to develop capacity need to be taken alongside the decision to contract out. This will help to ensure sustainability and design credible exit strategies. The core question to ask is what contracting capacities does the government want and need in the long-term? If contracting out is expected to be temporary, then the government needs to develop internal capacity to resume direct responsibility for functions and services. If contracting out is expected to be long-term or permanent, then the government will require internal capacity to manage and monitor contracts.

The government's vision for contracting out, whether it is to fulfil a stewardship role or to resume direct service delivery, has implications for the broader role of the state and its capacities. Some analysts have argued that contracting out may reduce incentives

for government to develop systems and processes for providing services directly. However, in principle, contracting out does not necessarily undermine the development of state capacity or legitimacy as long as the government retains a strategic role in oversight and monitoring the performance of contracts, establishing policy and regulatory frameworks, and setting service standards.

Capacity development is a continuous process which is best achieved by a sequencing of actions across a number of areas over time: recruitment of staff, provision of technical assistance, the progressive assumption of roles by government, and the assessment of progress against benchmarks (Box 3.4).

Using contracts to build sustainable capacity in government

The use of contracted service providers can fill the immediate capacity gaps facing a country, but a broader capacity development strategy is needed to manage the transition from dependence on external resources to long-term sustainability. This transition is integral to post-conflict restoration of service delivery, and it also influences the prospects for enhancing state-building and reducing fragility (Batley and McLoughlin, 2010).

Box 3.4. Three basic requirements for sustainable capacity development

Sequencing: appropriate sequencing is essential to the long-term success and sustainability of capacity development. Capacity cannot be developed simultaneously in all areas where gaps have been identified. Overcoming capacity gaps in certain areas is often a prerequisite to commencing successful capacity development in others. For example, an institution cannot implement a law or a policy effectively unless it has adequate institutional capacity to do so, in the form of resources, skills and management systems.

Coherence: Capacity development initiatives are often undertaken by different partners in an *ad hoc* manner, targeting certain gaps in government capacity but not others. However, fragmented initiatives tend to amount to less than the sum of their parts. For example, installation of a financial management system will not increase government capacity for financial management if government lacks trained staff to run the system. A key risk is that fragmented capacity development initiatives focuses on “soft” targets which are relatively

straightforward to implement, such as the provision of equipment, whilst neglecting more complex tasks. Joint development by government and donors of a capacity building plan in the context of a decision to contract out can help ensure the coherence of various capacity-building initiatives.

Commitment: Capacity development needs to be sequenced, continuous and coherent. This inevitably means that it takes time. There are no quick fixes, particularly in a fragile state. Long-term commitment is essential. Unfortunately, donor support in a fragile environment often has fairly short time horizons which are inconsistent with the long-term requirements of a sustainable programme of capacity development. Likewise, government commitment for a long-term process can sometimes be tenuous, depending on the shifting dynamics within government. Joint development by government and donors of a capacity-building plan in the context of a decision to contract out certain functions and services can help confirm commitment to the capacity-building process.

The sooner recognition of the need to plan for the transition is incorporated into the contracting out of service delivery, the easier it will be to avoid: (1) the development of parallel and disconnected service delivery systems (one dominated by international NGOs and contractors, the other operated by the government); and (2) dependence on an unsustainable level of external resources (Brinkerhoff, 2010). Unless the government can build capacity to assume responsibility for service delivery once a contract ends, those contracts will need to be extended, which continues dependence on donors and third-party contractors to support the functions of the state.

In many cases a contract for government services in a fragile state should therefore require that the

contractor helps to develop capacity in certain government institutions and/or employees. Concerns are sometimes raised that service providers have little incentive to develop government capacity, because the less capacity government has, the more likely it is that the providers' services will continue to be required and their contracts extended or renewed. However, if capacity development is clearly specified as an output in the service provider's contract, the service provider can be held to account for its performance in developing capacity (see Case Study 8: **Mozambique**). If the government eventually intends to resume responsibility for the function, the third-party contract could specify how services will be handed back to government over time, once the government's capacity has been

Case Study 8. Customs operations and reform in Mozambique

Mozambique's liberation struggle left it one of the poorest countries in Africa. The revenue that the Treasury was able to generate was initially very limited and the government budget was highly dependent on donor financing.

In the 1990s, the Government of Mozambique embarked on a process of fiscal and financial reform to facilitate trade, encourage investment and raise domestic revenue in order to be able to increase spending on development. It began by contracting an international firm to manage its customs operations. The contract also required the firm to select and train a new cadre of national customs officers and progressively to hand back responsibility for customs to government.

Start-up costs were partly financed by international donors, but as a demonstration of its commitment, the government decided to gradually meet the majority of the costs from its own resources, which had been boosted by the considerable revenue gains achieved (an increase of more than 350% despite several significant tariff reductions).

The contract had three distinct phases:

- Phase 1 (three years): management of customs on a delegated basis
- Phase 2 (three years): recruitment and training of new national staff
- Phase 3 (four years): mentoring and advice to new national managers

Each subsequent phase of the contract saw a reduction in the number of foreign consultants employed by the programme – approximately 50 in Phase 1, 30 in Phase 2 and 12 in the final phase – as government officials assumed increasing responsibility for management of customs operations. At the end of the third phase, all customs functions were once again managed by government, a new VAT department had been established and the foundations had been laid for the establishment of a revenue authority.

Lessons learned: By setting clear targets for phased transition of responsibilities over a realistic period, the customs management contract was able to combine external management of services with internal capacity building.

Source: Case study presentation at conference on Contracting Out Core Government Services and Functions in Post-Conflict and Fragile Situations, jointly organised by the PDG and the African Development Bank (AfDB), June 2009

developed. However, such provisions can only be incorporated in the contract if the government's capacity development needs have been identified in advance.

In developing provisions for capacity development (whether part of a broader service contract or as a separate arrangement), the government should determine its **objectives for capacity develop-**

ment. Whose capacity is to be developed? Is it government staff, service providers, university or vocational training students, citizens, local markets? What outcomes are desired and realistic? In addition the government should think through the best means to encourage the transfer of skills and capabilities from contractors to government. It should also consider provisions in the contract that protect brain drain from government to contractor.

In assessing how contractors can help build procurement capacity, **governments should be mindful that contractors may be ill-suited to develop certain capacities:**

- Contractors may know little of the local norms regarding corruption, and may not understand local anti-corruption laws and standards.
- Contractors are unlikely to understand the mechanisms for review, sanctioning and accountability used to maintain a procurement system with integrity. In fact, contractors may try to keep local enforcement mechanisms at arms' length, to avoid entangling themselves in the local legal systems in emerging nations.
- Contractors are unlikely to fully understand or embrace agencies' missions and organisational structures, or to be sensitive to the need to maintain management depth and continuity across time.
- Contractors may lack the management perspective or skills necessary to ensure that agencies develop the depth of skills necessary, at every level, to manage for the long term. For example, a provider of accounting services may not have the capacity to deliver accredited professional training for government accountants, or a primary health service provider may not have the capacity to train government medical staff to carry out complex tertiary care procedures.

Given these potential risks, when governments negotiate with contractors for delivering capacity development, it is important that they proceed carefully and thoughtfully and avoid relying too heavily on private contractors.

The **provisions for capacity development** can be part of the core contract for services or defined in a separate contract. Sometimes different firms provide services and capacity development, which means that separate contracts are necessary. Even when the same firm is providing both services it may

be advisable to split the contracts so that the capacity development contract can be cancelled (and perhaps given to another firm) or amended without affecting the service contract. Capacity development can be sequenced, with the contractor focusing on delivering services during the early stages of the contract, and capacity development intensifying as the contract proceeds. Performance indicators should be identified to monitor capacity transfers.

>TIP: In some circumstances, it may be preferable to separate service delivery and capacity development functions. For example, it may be better to use independent technical assistance rather than a service delivery contract to develop government capacity to make independent evaluations of a service provider's performance.

There are many types of capacity that might be built during a project – delivery of the service, procurement, management and oversight, etc. – and the government should include the priorities in the contract. Determining priorities will depend on the sector and type of contract. For example, current capacity-building efforts in **Nigeria** aim at developing procurement capacity in both the executive and the legislative branches of government to ensure that legislators can provide appropriate oversight for the emerging procurement functions in the executive branch. As demonstrated by the **Sierra Leone** case presented in Box 3.5, it is generally advisable to be very prescriptive in specifying the exact training, mentoring and other capacity development activities in the contract.

Many countries require that local providers be used in contracts procured by the government. As stated in Chapter 2, this approach has advantages and disadvantages. On the plus side, it encourages local capacity development, particularly among private sector service providers, and may provide economic benefits (private sector growth and jobs). On the other hand, these requirements can increase the price (despite the potentially lower wages for employees of local service providers) as the contractor

themselves will be likely to need capacity development, the contractor will have (or will perceive) a greater performance risk and quality could suffer. Requirements to contract local providers can also slow or stop procurements if the required local goods or services are not available, and can cause inflation by taxing limited local productive capacity. Before deciding to require local content, the government should have a good understanding of the current capacity of domestic service providers. An alternative approach is to include contractual provisions stating that local products and services will be sourced in preference to international products and services unless it is not practical, prices are higher or the requirements cannot be met.

Nations that are considering domestic preferences and related requirements should be aware that an array of international agreements – including the

World Trade Organisation's Agreement on Government Procurement and a multitude of regional and bilateral agreements – strongly discourage domestic preferences in procurement. If domestic preferences are put in place, and a political constituency develops over time to protect those domestic preferences, it may prove difficult to join those broader international agreements, which offer reciprocal access to other nations' procurement markets.

Once the decision to require (or to favour) local providers is made, this should be clearly stated in the contract. While it is good to encourage bidders to seek local input, care must be taken to ensure that they follow through and deliver this under the contract. Contract terms relating to local providers could include requirements to employ local workers and to provide domestic organisations with a fair opportunity to compete in the supply of goods and/or services.

Box 3.5. Capacity development in Sierra Leone's National Revenue Authority

During the country's recovery from 11 years of conflict, the Sierra Leone National Revenue Authority (NRA) was set up in 2003 as a unified authority to improve revenue collection. In late 2005 an overseas contractor was hired by the UK's Department for International Development (DFID) to help the NRA to implement a value added tax, increase government revenues, and strengthen administration and procedures. In 2006 it became clear to donors and NRA management that the NRA was

underperforming and a comprehensive nine-month modernisation programme was developed. DFID amended the contract to concentrate less on theoretical training and advice and more on the transfer of skills and changes in processes and attitudes. The contract provided for expatriate consultants to work in the field alongside NRA staff. It also provided for weekly interactive classroom training on practical tax collection issues for select NRA staff.

Factors which could undermine sustainable capacity development

Without proper planning and agreement between partners, sustainable capacity development can be undermined by a number of factors:

- **Failure by government to recruit or allocate staff and other resources** will limit the amount

of capacity that can be built, even if the right tools for capacity development are available.

- **Failure by donor partners to align technical assistance with government's priorities** and needs; the parts of government which receive technical assistance may be driven by donor interests and priorities.

• **Reluctance by government to reassume responsibility for the function which has been contracted out**, either because of lack of ownership, or because of concerns over the level of internal capacity (see Case Study 11 on **Afghanistan** in Chapter 5).

• **Insufficient flexibility**, either on the part of government or donors, **to respond to lessons learned** during capacity development, or to redirect resources and efforts to emerging needs.

To overcome these obstacles, government and donors need to agree a clear strategy for the transfer of the skills at the outset of the contracting-out

process (Table 3.2). This strategy should identify:

- Targets for recruiting government staff.
- The level and nature of technical assistance to be provided by donor partners.
- Clear timelines for the government to gradually reassume responsibility for the contracted-out function.
- Measurable benchmarks throughout the process which enable stakeholders to evaluate whether the strategy is on track.

Table 3.2. Overcoming obstacles to sustainable capacity development

Factors which could undermine sustainable capacity development	Mitigation measures to be included in a capacity building strategy
Failure by government to recruit or allocate staff and other resources	<ul style="list-style-type: none"> • Targets for recruitment of government staff
Failure by donor partners to align technical assistance with government's priorities	<ul style="list-style-type: none"> • Agreement on the level and nature of technical assistance to be provided by donor partners
Reluctance by government to assume increasing responsibility for the function	<ul style="list-style-type: none"> • Clear timelines for progressive government assumption of responsibility for relevant function
Insufficient flexibility to respond to lessons learned	<ul style="list-style-type: none"> • Measurable benchmarks throughout the process which enable stakeholders to evaluate whether the strategy is on track

References

Batley, R. and McLoughlin, C. (2010), "Engagement with Non-state Providers in Fragile Situations: Reconciling state-building and service delivery", *Development Policy Review* 28.2: 131-154.

Brinkerhoff, DW. (2010), "Developing Capacity in Fragile States", *Public Administration and Development* 30(1): 66-78.

Lusthaus, C., et al. (2002) *Organizational Assessment: A Framework for Improving Performance*, International Development Research Centre, Ottawa, available at www.idrc.ca/en/ev-27697-201-1-DO_TOPIC.html.

OECD (2009), *Bridging State Capacity Gaps in Situations of Fragility*, Partnership for Democratic Development, OECD, Paris.

Useful resources

Resource centres

1. World Bank Capacity Development Resource Centre

www.worldbank.org/capacity

An overview of literature, lessons learned, and good practices, as well as links to development agencies and other knowledge sources

2. LenCD Learning Network on Capacity Development

www.lencd.org

An informal network of analysts and practitioners working on capacity development

3. European Commission: Capacity4Dev

[http:// capacity4dev.ec.europa.eu](http://capacity4dev.ec.europa.eu)

An open forum supporting the European Commission's efforts to improve practice on technical cooperation

4. Capacity.org

www.capacity.org

Online portal and magazine on capacity development from the European Centre for Development Policy Management

Policy guidelines and toolkits

1. Delivering the Goods: Building Local Government Capacity to Achieve the Millennium Development Goals,

United Nations Capital Development Fund

<http://tinyurl.com/3achjsd>

Lessons and guidelines for local government capacity-building in development programmes, including strategy, financing, public investment expenditure management, accountability, communications and information.

2. The Capacity Development Results Framework
World Bank

<http://tinyurl.com/364j8yt>

Guidance on the design, strategy, evaluation, and management of capacity development initiatives. It emphasizes the diagnosis and understanding of institutional capacities.

3. Building Capacity in Post-Conflict Countries

World Bank

<http://tinyurl.com/3aeh8b7>

When conflicts end, both the local population and international community have high expectations that living conditions in a country will improve. This article argues that the best option is to create permanent capacity, and suggests lessons for more sustainable capacity building.

Other resources

1. Otoo, S., Agapitova, N. and Behrens, J., 2009, 'The Capacity Development Results Framework', World Bank

<http://tinyurl.com/2ujkb6e>

This is a step by step guide to planning, implementing and evaluating capacity development programmes.

2. Brinkerhoff, D., 2008, Capacity Development in Fragile Environments: Dilemmas and Directions, Capacity.org

www.capacity.org/en/journal/feature/dilemmas_and_directions

This article addresses issues and dilemmas that the international community face in relation to how they can support sustainable capacity development in fragile states

3. Boesen, N., and Therkildsen, O., 2004, 'Between Naivety and Cynicism: A Pragmatic Approach to Donor Support for Public Sector Capacity Development', Danish Institute for International Studies, Copenhagen

www.um.dk/NR/rdonlyres/E8B62C6A-C0E8-456E-9-C88-2C075FECA7F0/0/CDEstep4_APragmaticApproachtocapacitydevelopment.pdf

This paper aims to help identify what capacity may be possible under present and foreseeable conditions in poor countries and if opportunities for capacity development exist, what can outsiders such as donors do to support and encourage them.

4. Lusthaus, C., *et al.* (2002) Organizational Assessment: A Framework for Improving Performance, International Development

Research Centre, Ottawa

www.idrc.ca/en/ev-23987-201-1-DO_TOPIC.html

This book offers a methodology to diagnose institutional strengths and weakness at the onset of development activities

5. OECD (2009), Bridging State Capacity Gaps in Situations of Fragility, Partnership for Democratic Development, OECD, Paris.

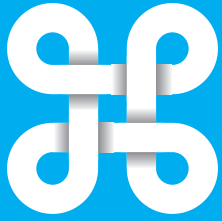
<http://oecd.org/dataoecd/1/18/42416165.pdf>

A series of case studies which identifies specific bottlenecks and successes when using technical assistance in core government functions and services.

6. Browne, S., and Hilderbrand, M., 2002, Developing Capacity through Technical Cooperation, United Nations Development Programme, New York

<http://lencd.com/data/docs/163-Developing%20Capacity%20Through%20Technical%20Cooperation.pdf>

This book provides inputs into the thinking about the contribution of technical cooperation to capacity development on the basis of practical examples.



Chapter 4

The procurement
process: planning,
preparing, awarding
and monitoring
the contract

What's in this chapter?

This chapter describes the next steps to be taken once a government has decided to contract out services and/or government functions.

The chapter covers:

- > The main government roles in procurement.
- > How to decide what services are needed.
- > How to plan the procurement process.
- > How to prepare and issue a tender so that competition and fairness are maximised.
- > Using international procurement good practice and principles to assist the decision-making process, when appropriate.
- > How to award a contract and monitor its performance.

Key lessons learned

- > A structured and planned approach to procurement improves the partner government's chances of successfully contracting out the desired services at a reasonable cost.
- > Ideally, international best practice should be applied to guide the procurement process and to help achieve transparency and competition. However, in a fragile situation, technical challenges may render it difficult or even impossible to implement the full range of international best practices and still deliver urgent services in a timely manner. There are certain short-term solutions that can be implemented to overcome these challenges.

4.1. The procurement process

Once the decision is made to contract out a government service or function, procuring these services involves a number of steps (Box 4.1). This chapter follows these steps, which reflect international good practice in procurement. However, as each fragile situation is unique, this chapter also outlines how the process might be modified when a country's situation does not allow for all the steps to be taken.

This chapter will provide guidance and tools for partner governments on how to design and manage the procurement process in order to maximise the probability of a successful outcome. This discussion refers to three primary public sector roles – technical, procurement and financial (see Box 4.2).

Procurement can be a complex process that requires choices to be made among various alternatives. Some of the key factors in the decision-making process are highlighted in the following decision diagrams and discussed in this section. The diagrams are designed to serve as a guide or starting point for government officials when considering how to contract out government functions or services. Naturally, each government may face unique factors that should also be considered in contracting out and cannot be captured by these diagrams.

Retaining clear government ownership

The parties to contracts will in most cases be a national or local government agency (the government) and a third-party service provider (the contractor). In some cases donors may be parties to contracts. In summary, contracts can be:

1. government-funded and procured;
2. donor-funded and government procured; or
3. donor-funded and procured.

Donors will usually have their own standard contract forms that they use when procuring services. If donors require their procurement rules to be followed rather than the national procurement law the system can become rather complex. There are approaches that can be used to manage this complexity, including the use of a procurement agent and encouraging donors to allow the use of government procurement requirements.

A programme strategy that positions the functions to be contracted out within the framework of government policy is particularly important in the third scenario, where contracted services or functions are financed and executed externally. In this scenario, the role of partner government policy makers and officials in providing leadership through strategy, programme design and objective monitoring is critical. This will ensure that donor-funded and executed activities are a part of the broader government strategic framework and complement other services provided directly by the partner government.

The ultimate goal of contracting out is the delivery of quality services and/or government functions on a national, regional or targeted local basis. Working through contractors to achieve partner government goals requires the government to be clear about what it would like to achieve, where it should be delivered, in what quantity, over what period of time and according to which standards. The government should provide clear guidance to potential suppliers or service providers in order to better achieve these deliverables and the government's broader goals and objectives. The procurement should also be performed in an open and transparent manner, as this will minimise the potential for corruption, and help the partner government achieve the most competitive price for the contracted services or functions.

Box 4.1. Steps in the procurement process

- **Defining and initiating the contract:** This first step defines the contract's requirements and performance standards so that they reflect the needs of the end users and the urgency of the requirement. Decisions are needed on the timeframe for service delivery and the preferred contracting approach.
- **Planning the procurement:** The procurement plan details the procurement process, the sequence of actions required, the responsible parties and the schedule. This plan is an important management tool which helps guide the partner government and improves the probability that the desired results will be obtained.
- **The tendering process and choosing the contractor:** Through the tendering process a request for tender (RFT) is prepared and issued, the evaluation process is established, tenders are evaluated, and the contract is awarded.
- **Finalising and monitoring the contract:** The fourth and final step is the post-award stage, where contract monitoring, implementation and evaluation occur. This includes deciding whether government will reassume responsibility for the services at the end of the contract, or if it will continue to contract them out (although remaining engaged through monitoring and evaluation, etc.).

Box 4.2. Primary public sector roles in procurement

- **The technical role:** This typically resides within the central government or line ministry, or in regional or local government for sub-national procurement. This role provides, or oversees, the technical expertise necessary to define service needs, evaluate the range of possible service providers, estimate contract costs, determine basis of payments, and evaluate providers' tenders and contract performance. In other words, the technical role provides the expertise which is not inherent to the procurement process itself. This will require sector-specific knowledge (e.g., an understanding of the government's healthcare or telecommunications requirements).
- **The procurement role itself:** This may be performed by a separate procurement agency or unit or by an authorised procurement official within the agency that requires the contract. The procurement role includes managing the day-to-day procurement process and ensuring that the relevant laws, regulations and procedures are followed (i.e. ensuring the integrity of the procurement process). Key procurement decisions may be made by the assigned technical and procurement personnel, or may be deferred to a higher-level decision-maker, consistent with national practice.
- **The financial role:** For a national procurement, this typically resides within the central government or line ministry, co-ordinated by the Ministry of Finance. For sub-national procurement, the regional or local government would perform this role. The financial role includes certifying the availability of funds and making payments to the service provider. This role requires close co-ordination with the technical and procurement functions; for example the former might authorise payment of a contractor invoice, which the financial function would then process.

Case Study 9. Southern Sudan: the importance of getting the procurement process right

In 2005, after 22 years of civil war, health service coverage in Southern Sudan was extremely limited. Where services existed, they were provided by non-governmental organisations (NGOs), the church and other non-governmental agencies, together with local communities. In 2006, a joint government-donor Umbrella Health Programme was established. The programme aimed to contract lead NGOs to work in consortium with other local partners. Their task was to deliver immediate basic health care to up to 50% of the population in each of Southern Sudan's ten states while the core capacities of the government health system were developed.

The procurement process for delivering basic health packages in the ten states was launched in April 2006, using World Bank procedures. Expressions of interest (Eols) were requested from NGOs interested in acting as a lead agent in a state. However, the government only received adequate responses from NGOs from four out of the ten states. It therefore moved to the request for proposal (RFP) stage with the first four states in November 2006, while reissuing the Eol for the remaining six states in 2007. Once the detailed proposals were received from NGOs for the first four states, it became clear there was a significant problem. The proposals received were for significantly higher amounts than the funds available for each state, often by a multiple of ten or more. The Ministry of Health therefore embarked on an extended contract negotiation process with the four selected NGOs, which lasted from 2007 until 2008.

Following these extended negotiations, the basic health delivery contracts began in two states in the second half of 2008, a full two years after

the Umbrella Health Programme had been established. Contracts also began in a further two states in 2009. Meanwhile, the Ministry of Health issued RFPs for the remaining six states in mid-2008.

These delays meant that the Umbrella Health Programme failed to meet its initial objective: the immediate delivery of essential services. More than three years after the programme was approved, only four states had started to receive basic health services. The delays can be attributed to a combination of factors, including:

- The lead times involved in procurement using World Bank procedures, exacerbated by limited procurement capacity in the Ministry of Health, and the need to process World Bank “no objections” through Washington.
- Ambitious initial programme design, which subsequently required protracted contract negotiations to scale contracts back to the limits of affordability.
- Limited capacity of NGOs to understand or comply with the procurement procedures used, or to meet the necessary service delivery standards.
- The requirement for lead NGOs to provide bank guarantees for 20% advance payments before mobilising.

Lessons learned: A decision to contract out service delivery must be accompanied by a procurement process which reflects the situation, including the capacity of the government to manage procurement processes, and the capacity of targeted providers to comply with them.

Source: Davies, F. (2009), “Contracting Out Government Functions and Services in Southern Sudan”, in OECD (2009) Contracting Out Government Functions and Services, OECD, Paris

4.2. Defining and initiating the contract

In this initial stage of the procurement process (Figure 4.1), the government:

- develops a service strategy;
- identifies the service needed;
- identifies the required capacity for long-term service provision and how it will be developed;
- ensures the adequacy of funding; and
- defines the contractual approach.

The outcome of this process is a well-defined service that can be readily tendered for and executed. Each step in the process is discussed in turn below.

Develop a service strategy

The partner government should ideally first develop a strategy to guide service delivery. A service delivery strategy helps a government meet its service goals and objectives and provide an integrated and efficient service to the community. A strategy will also help government co-ordinate its service delivery with other services that may be externally delivered by multilateral organisations or bilateral donors. Strategies can be:

- Sectoral – such as for health or education – and can address a range of subsectors, such as infant health or adolescent health.
- Regional or local, particularly if the needs of different areas – such as rural and urban areas – differ considerably.
- Designed to assist in the delivery of government functions, for example defining how an agency will undertake its financial management responsibilities. In this respect, a government strategy for service delivery is a critical tool for determining how the agency will meet these responsibilities and best use limited resources.

In developing a strategy, it is important to consider the risks of the various options, which can be political, organisational, financial, and operational. Risk assessment (referred to in Chapter 2) directly affects the procurement process. For example, in reviewing potential service providers, the partner government may decide that, due to capacity limitations (*e.g.* organisational weakness), local contractors are a more risky option for providing rural health services than international NGOs. This would be reflected in the subsequent procurement plan by targeting service providers in the international community.

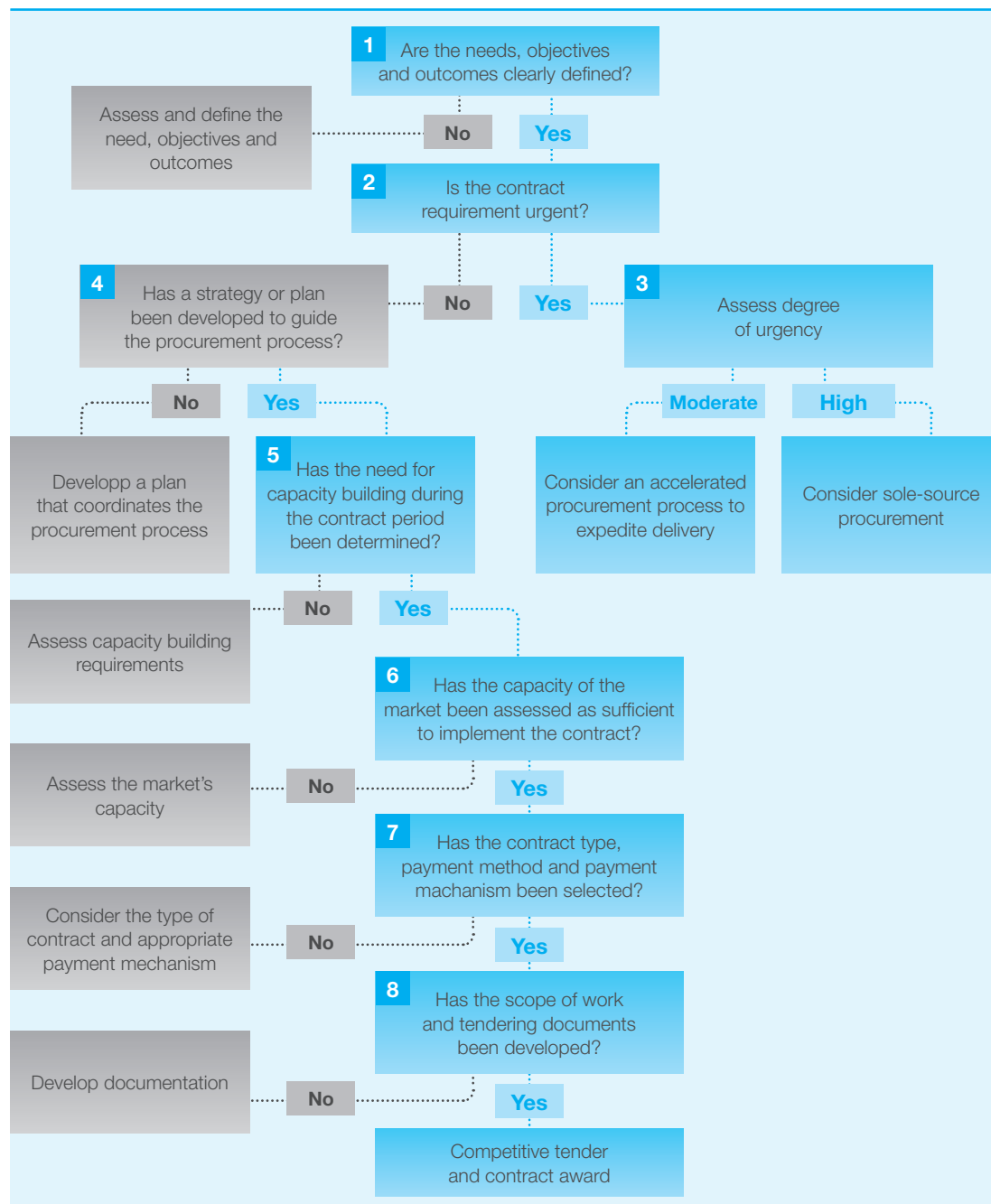
>TIP: Preparing and identifying a strategy helps the government to develop and define its service goals and objectives. However, in fragile situations there may be urgent requirements that should not wait for a strategy to be developed. In such instances, a short-term contract (*i.e.* 6-12 months' duration) can be used while the government refines its strategic approaches. The lessons learned from the interim contract can then be built into the longer-term contracts.

Identify the service goals, objectives and priorities

The next step in the planning process is to ensure that the service goals, objectives and priorities are clear. Key questions to be answered include:

- What is needed, who requires it and can it be clearly defined?
- What outcomes do we want and are they realistic?
- How can we achieve these outcomes?
- When, where, how often, or for what period of time are these services required?
- Is the need urgent and can how quickly can it be met?

Figure 4.1. Decision tree: contract initiation and definition



Answering these questions is crucial to adequately describe the service requirements to potential providers during the tendering process. Usually these questions can be answered through a needs assessment, which can be either formal or informal. The process for conducting a needs assessment will depend on the nature and complexity of the services sought, as well as the capacities of government. However, it is essential that the government plays a lead role in conducting the needs assessment. A consultative process between all stakeholders involved in the service can help to define the needs and will benefit the government's broader service delivery strategy. Consultation can take place in a formal setting or in less formal community gatherings and should ideally include:

- Government decision makers
- Representatives of the private sector and NGOs
- International organisations that may be working in the community
- Multilateral organisations or bilateral donors supporting the contracting-out process
- Service recipients
- Civil society and other organisations that may be interested in making proposals for how to meet community needs
- Potential service providers.

A consultative process can help to build public support for contracting out, and draw the skills, knowledge and experience of the various stakeholders into the planning process. The consequences of failing to achieve adequate consensus are outlined in Chapter 2.

The assessment also identifies the different options for providing the service. The best option will meet the service need effectively and efficiently and will be readily executed by all parties. Identifying this option often reflects lessons learned from previous experiences or in nearby states. The availability of financial resources, capacity and time are important factors in deciding among options, as well as the region's social, economic and political situation. If the

need is urgent, then it may be preferable to address the most immediate requirements in an initial contract, while preparing another contract to address longer-term, strategic needs (see Chapter 3).

It is also important to consider whether the intended results and outputs are appropriate or achievable in the context. The service needed may be simply defined, such as providing access to water or health-care to the entire population; or it may be defined in more elaborate terms, such as providing access to clean water for x percent of a local community for at least x hours per day. The details of the contract will depend on the government's contract objectives, the contract type, and the availability of reliable quantitative data against which to assess outputs.

As discussed in Chapter 1, needs should be defined in terms of desired outcomes where possible, but in fragile states it is much more likely that they will be defined in terms of outputs (and see Annex D). This allows the contract payments to be tied to achieving specific objectives or performance levels. This performance or output-based contracting provides incentives for the contractor to deliver the services required. This approach also reduces the potential for corruption and ensures that government objectives are clearly stated in the contract document.

There is growing recognition of the relevance of output-based approaches to service delivery in fragile states. DFID and the World Bank established the Global Partnership on Output-Based Aid in 2003 to promote output-based approaches to service delivery in the water, sanitation, electricity, telecommunications, transportation, health and education sectors. Annex D illustrates how output-based approaches have been used in fragile states.

Identify the capacity development requirements

As we outlined in Chapter 3, the government will also need to consider its long-term strategy for service delivery and the implications for capacity

development. The following questions should be considered:

- Does the partner government intend to contract out service delivery on a long-term basis?
- Does it intend eventually to develop the necessary capacity to deliver services directly (not through contracting out)?
- If so, does it plan to develop its capacity by contracting for the capacity development expertise needed, and if so, will this be under a separate contract, or under the same contract through which it engages short-term service delivery?

Chapter 3 discusses the various approaches to capacity building that can be adopted in the context of contracting out, and identifies the risks associated with failing to do so.

Ensure adequate funding and links with donor-funded activities

The availability of funding to pay for the contracted services or government functions should be confirmed early in the process. This will require the partner government to be able to make a rough estimate of the value of the contract, including the cost of labour, supplies, transportation and other costs that the contractor will incur in providing the service or function. Specialised technical assistance from sectoral and financial experts is frequently used for developing this estimate. The government also needs to be able to manage finances and forecast its needs for contracting out. Again, this can be done with assistance from donors but the government should develop this capacity as quickly as possible. Over time, the government will be able to reduce its procurement costs if it can forecast its procurement activity with reasonable accuracy, and can have procurement agents take on that activity on a firm fixed-price basis.

If the funding is provided to the partner government by a donor, the donor may require that certain aspects of the procurement process conform to its specific procurement standards. If adequate funding is not available, the partner government may need to decrease the scope of the requested service, for example by focusing service delivery on the most urgent areas within a region, rather than targeting the entire region; deferring contracting out until funding can be secured; or returning to the planning process discussed in Chapter 2 to identify alternatives to contracting out.

Define the contractual approach

There are two basic approaches that can be used depending on whether the service is needed urgently (as is frequently the case in post-conflict or fragile states) or whether there is time and partner government capacity for a more ordered and structured procurement process. The two types of contracting are **competitive bidding** and **sole-source contracting**. Competitive bidding is when the government requests tenders from a number of sources which then compete with one another to be awarded the contract.

Sole-source contracting is when the government provides a request for tender (RFT) to only one bidder. Sole sourcing should be considered when there is an urgent need for goods or services (*e.g.* to fill a critical service vacuum in a post-conflict situation – see Case Study 10 below), or where there is only one feasible service provider (Figure 4.2). While sole-source contracting can be effective in these situations, it should generally be used only as a short-term solution. In the longer term, competitive procurements obtain more favourable pricing, and allow the government to select from amongst several potential bidders based on technical merit and pricing. A transparent, competitive environment also reduces the potential for rent-seeking behaviour.

Case Study 10. Using sole-source contracting to avoid service delivery gaps

The **Afghan** Interim Administration was established in November 2001, and faced a range of emergency needs, including in the area of procurement support. The World Bank developed an Emergency Public Administration Programme in order to meet these needs, including contracting a procurement agent to support the administration's procurement capacity (see Case Study 6 in Chapter 3). Given the time taken to establish the programme and put all the necessary requirements in place, it became clear that contracting the procurement agent would take some months. As a result, the UK's DFID provided bridging financing in order to provide the administration with interim procurement capability whilst the emergency programme was put in place. This allowed a temporary agent to be contracted to provide procurement support on a sole-source basis through a framework contract between March and August 2002, until the procurement agent under the World Bank's Emergency Public Administration Programme was in place. This approach helped provide the Afghan administration with early procurement support, and avoided a procurement backlog.

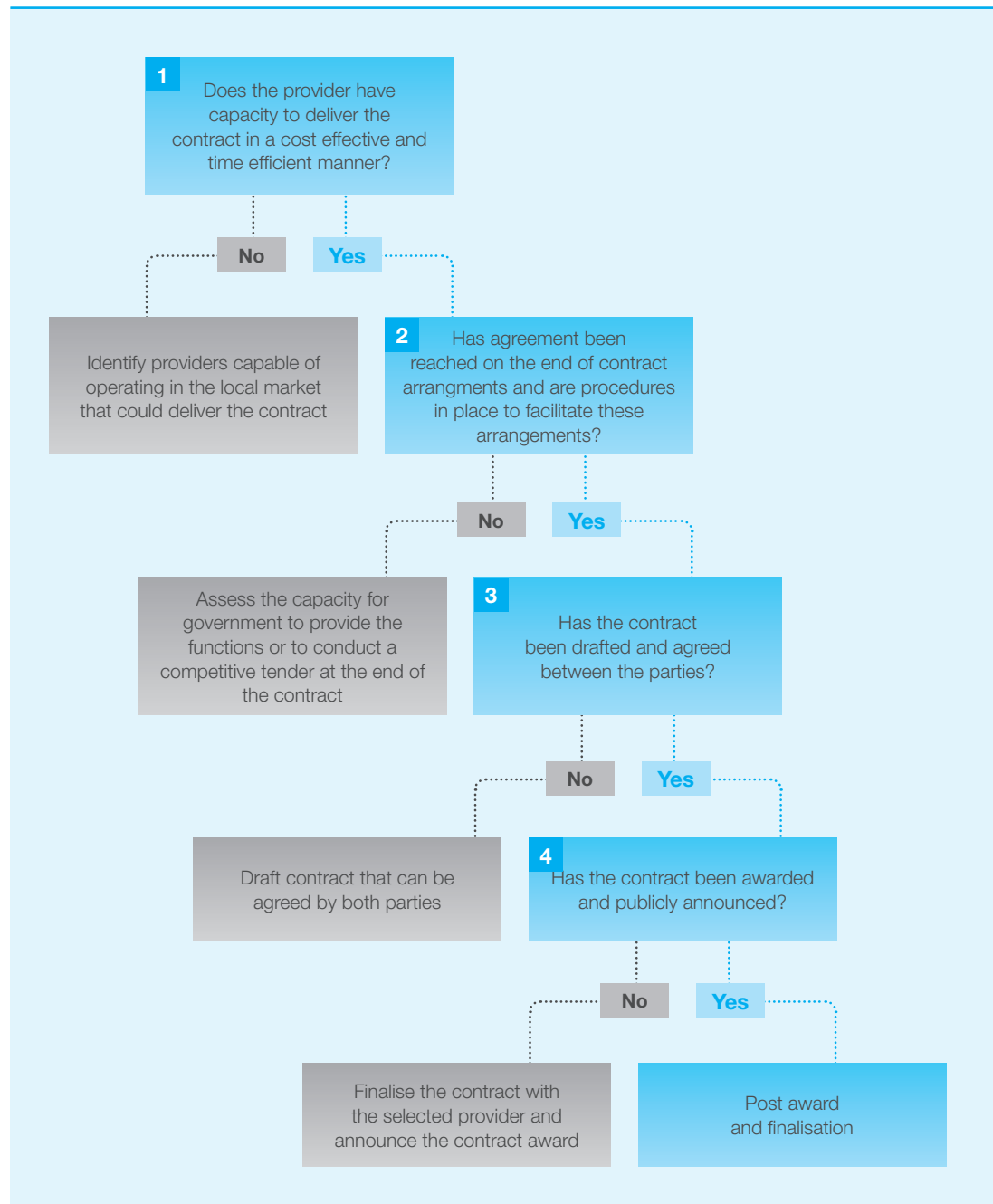
When the Government of **Southern Sudan** (GoSS) was established in October 2005, it had no procurement capacity whatsoever. The government rapidly agreed to contract a procurement agent to conduct all procurements on its behalf through the Multi Donor Trust Fund (MDTF) Core Fiduciary Services Project. A competitive tender for the procurement agent was launched in December 2005, using World Bank procedures. However,

no provision was made for interim support on a sole-source basis in the meantime. The competitive process took over a year to complete, and the procurement agent only started work in February 2007. It quickly became evident within the procurement agent's inception phase that it faced a number of significant challenges in executing its terms of reference. Procurement had been going on for over a year in the absence of a procurement agent. In the case of MDTF procurements, spending agencies had attempted to follow World Bank procedures, but since their knowledge of them was limited, their progress was slow, and standards were low. As a result, there was a large backlog of work, and a rapidly-emerging perception that the MDTF was failing to meet its objectives. In the case of GoSS procurements, individual spending agencies had embarked on their own procurement processes with little or no reference to the GoSS procurement regulations. Even once the procurement agent was in place, it proved impossible to reassert a centralised approach to government procurement, and it was not uncommon for contracts to exceed their budgets.

Lessons learned: Appropriate use of sole-source contracts can help meet urgent service delivery needs whilst longer-term support arrangements are put in place using competitive procedures. Failure to meet urgent service delivery needs during the critical phase of government establishment can lead to perceptions of non-delivery, and can also enable sub-standard practices to become embedded within government.

Source: "Case Study Presentation", African Development Bank (AfDB)-OECD joint conference on Contracting Out Core Government Services and Functions in Post-Conflict and Fragile Situations, Tunis, June 2009

Figure 4.2. Decision tree: sole-source bidding



>TIP: When a service is needed urgently, the government should consider a short-term, sole-source contract to provide the service, while building the capacity to engage in a competitive procurement for a longer-term contract.

A typical distribution of responsibility across departments for the contract initiation and definition phase is illustrated in Table 4.1. Unlike the capacity assessment, this and the subsequent phases of the procurement process are usually specific to particular contracts, because they deal with detailed factors unique to each procurement. An exception

would be when the government contemplates a number of near-identical contracts, for example a series of regional contracts to provide similar sets of health services.

Each government ministry/department would house all these functions (except in rare cases where procurement is fully centralised initially, as may be the case with a central procurement agent). How they would function depends on the extent of centralisation of procurement and financial management in the specific ministry/department.

Table 4.1. Typical roles for initiating and defining a contract

Role	Responsibility
Head of contract user / technical agency	Approves the need for the service and proposed contracting approach. Supports sourcing or creation of additional capacity as required.
Project manager / technical staff	Identifies required capacity and assesses contracting approach. Confirms the service need, service goals, objectives and priorities and identifies the service strategy. Helps identify and plan procurement, proposing procurement plan for projects.
Finance department	Confirms adequate funding availability.
Procurement staff	Assist in planning and confirm contracting approach. Help identify and plan procurement activities, proposing procurement plan for projects.
Legal adviser	Provides legal advice on contractual approach.

4.3. Planning the procurement

The procurement plan lays out the details of the procurement process, and the steps that will be required. Typically, the key parties representing the partner government's technical and procurement roles work together to prepare the procurement plan (Table 4.2).

The procurement plan should identify the following, which will then be reflected in the request for tender and in the contract itself. Each of these points is described in the sections which follow:

- Goals and objectives of the procurement
- Potential service providers
- Contract duration
- Procurement approach
- Payment approach
- Scope of services required
- Contract monitoring and evaluation
- Tender format
- Tender evaluation
- Procurement schedule
- Cost estimate.

Goals and objectives of the procurement

As previously discussed, the procurement goals are established when the procurement plan development begins. The purpose of the plan is to establish a structured process for ensuring that those goals and objectives are achieved by the procurement.

Potential service providers

In the procurement planning process, the partner government should assess the market's financial and technical capacity to provide the required services or government functions. Initial focus should be on the local market, as these organisations are already familiar with local conditions, and using them would create local jobs (but see discussion in Chapter 3). First, the potential providers should be identified

in the relevant sector. Market analyses may already exist of private sector providers in different industries, and these can be used.

Contract duration

The procurement plan should state how long the contract should last. For a one-off event, such as a census, the event itself will determine the contract duration (*i.e.* the length of time required to plan, prepare for, conduct and report the result of the census). For ongoing services, such as security or healthcare, the partner government has more options.

When an ongoing service is needed and there is enough time to complete a competitive procurement process with well-defined performance standards, the government may wish to consider a long contract period, up to five years. This can be structured as a one-year contract, with four additional one-year option periods. This gives government the flexibility to re-tender the contract if the service provider's performance is poor, so that the government is not locked into a poorly performing contract. Note, however, that a shorter contract term may lead to a higher contract price.

If data are not available to define the required performance standards with confidence, or if the urgency of the requirement dictates a sole-source procurement, the partner government may wish to put a short-term contract in place, while planning a more structured, competitive procurement for the future.

The duration of the contract raises important issues both to ensure a good procurement result, and to manage legal aspects of the contract. The legal and contractual aspects, such as pricing implications, are addressed in Chapter 5.

Procurement approach

The procurement plan should also state whether the partner government intends to conduct a competitive or sole-source procurement (see above), and the rationale for that decision.

Payment approach

There are a few different payment approaches available:

- **Fixed price:** In a fixed-price contract, the contractor is obliged to perform a specific service(s) or government function(s) for a fixed amount (*e.g.* provide water treatment and plant operation services in a town for one year for payment x). A fixed-price contract is possible when the service, performance standards and quantity of work are known. In these circumstances, a fixed-price contract is desirable because it transfers the performance risk to the contractor, who must deliver the services in order to be paid. A fixed-price contract also makes budgeting easier, since the cost is known in advance. However, if the service is not clearly defined, a fixed-price contract may not be appropriate, since the government risks paying too high a price for the services received, or too low a price, leading to poor contract performance.

- **Unit price:** In a unit-price contract, the contractor is paid by the unit for services performed (*e.g.* payment x for each injection given). This is an output- or performance-based contract. A unit-price contract is appropriate when the service and performance standards are known, but when there is uncertainty about the quantity of service required. When a unit-price contract is used, the government should include in the contract a ceiling or maximum number of units to be provided, to ensure that it retains control of contract expenditures. As with a fixed-price contract, payment is based on performance, so the service delivery risk is transferred to the contractor.

- **Labour contract:** In a labour contract, the contractor is paid on the basis of staff-time provided (*e.g.* payment x for each day of staff time provided). This is an input-based contract. This can be a useful approach when the services, performance standards and quantity of work are unclear (*e.g.* when the contractor is sending medical teams into a remote area). In this situation, the performance risk remains with the government, since the contractor is paid for being on the job, not for accomplishing specific tasks or outcomes. Ideally, this type of contract should be used only on an interim basis while the partner government collects data which will allow it to better define the services, performance standards, and requirements for future contracts.

- **Performance or output-based contract:** Where possible, the first two payment mechanisms can be combined with a performance or output-based approach, under which the contractor is only paid for those services or outputs which meet the performance criteria of the contract. This can provide a powerful incentive for delivery of good quality services, but also requires a rigorous and objective approach to unit costing and quality monitoring by the government. The related concept of output-based aid is discussed in Annex D.

Scope of services required

The procurement plan should provide a clear picture of the partner government's requirements, known as the "scope of services". This will assist in preparing the request for tender (RFT), which needs to specify the government's requirements so as to set the same expectations for all potential bidders. The RFT should include a clear description of the services needed, including the estimated workload, the associated performance standards, and when and where the services need to be delivered. The performance standards should be quantitative and measurable, where possible. Workload should be expressed in meaningful units, such as the number of households served, units of service to be provided, or frequency of service delivery.

- Accurate workload and performance data are essential to allow the contractor to estimate costs and to enable the partner government to evaluate the contractor's proposal. The challenges of data availability and accuracy in a fragile state have already been discussed. Nonetheless, poor data increase the likelihood of poor performance. There are two ways to address this issue. If time permits, the partner government may collect the required data or engage an independent service provider to do so. Alternatively, the contracts should require the contractor to collect and provide this information to the partner government. This information can then be used to refine the contract through amendment, or to support a more detailed follow-up contract.

Contract monitoring and evaluation

A clear description of how the contractor's performance will be monitored and evaluated after the contract is awarded is also an important part of the procurement plan. It is also a key component of the RFT, particularly when contract payments are closely linked to performance standards.

Performance monitoring can be defined in several ways. For example, the RFT may state that there will be a quarterly audit of the contractor's work documentation, or monthly evaluation visits to a sample of contractor work sites to ensure that work is being performed in accordance with the contract. Ideally payments should be linked to performance so that the contractor has an incentive to meet the performance standards, and the process by which this will be accomplished must be clearly described. The procedure for terminating the contract due to poor or non-performance must also be clearly described. If the partner government anticipates that it will require access to contractors' records or reports as part of the contract monitoring process, this access and the type of documentation required must be specified in the RFT.

Tender format

It is important to define the desired tender format in the RFT and the procurement plan. This makes it easier for bidders to respond, since they understand the government's expectations. When all the tenders are in the same format it also simplifies the government's tender evaluation process – a “like for like” comparison can be made of each bid.

Ideally, the tender should provide the partner government with enough information to evaluate whether the bidder understands the government's requirements and is likely to be able to deliver the required services. For example, the partner government might require bidders to provide information on their approach to performing and managing the required services; a staffing plan (how many personnel and what types of skills); curriculum vitae (CVs) for key personnel; details of prior organisational experience in performing similar services; and the proposed cost.

However, there is a balance to be struck between requesting too much information – which can discourage bidders from participating in the procurement and make the government's tender evaluation more difficult – and too little information, which may result in the wrong bidder being selected. In a fragile situation where small local firms are the likely service providers, private sector capacity to develop formal proposals may be severely limited. This limitation should be considered when developing tender documentation. In these contexts, international firms may be better equipped to participate in the bidding process for government functions, which gives them a clear (sometimes perceived as unfair) advantage over local competitors. Donors often help build private sector capacity by supporting development of the basic skills to submit valid tenders.

>TIP: For basic services, the partner government may limit the requirements to a statement of the price, the designation of key personnel and a signed statement that the bidder understands

the requirements and will provide the requested services as specified in the RFT.

Tender evaluation criteria

Developing the evaluation criteria is a key aspect of the procurement plan. The RFT should clearly state the evaluation criteria that the partner government will use to assess tenders so that bidders can prepare their bids to maximise their chance of winning the contract. The evaluation criteria might include the cost, the technical approach, experience of key personnel, and corporate experience of similar projects or within the country/region, etc.

Procurement schedule

The procurement plan should include a detailed timeline of the key steps leading from the plan to the implementation of an awarded contract. This includes the following milestones:

- Development of draft procurement plan
- Development of final procurement plan
- Advertisement of request for tender

- Public meeting with interested bidders (or receipt of written questions)
- Response to bidder questions
- Deadline for the receipt of tenders
- Evaluation of tenders
- Negotiation and award
- Contract start-up and start of monitoring and evaluation
- End of contract

Cost estimate

During the procurement planning process, the likely cost of the contract should be estimated. This estimate can then be used to ensure that the required funds are available and ready to be spent on the contract. It will also be used to assess the reasonableness of the costs proposed by the bidders in their tenders.

The preceding paragraphs have described the procurement planning process. Table 4.2 depicts typical roles for key participants in this process.

Table 4.2. Typical roles for procurement planning

Role	Responsibility
Head of contract user / technical agency	Approves the financial procurement plan
Head of procurement agency	Approves the financial procurement plan
Project manager / technical staff	Takes lead in developing technical input to all aspects of procurement planning: requirements, market capacity, contracting process.
Procurement staff	Take lead in developing contracting process to achieve service need objectives while complying with legal, regulatory and procedural contracting requirements.
Finance department	May provide input to contract cost estimate.
Legal adviser	Provides legal advice on the contractual approach.

4.4. The tendering process and choosing the contractor

The competitive tendering process involves a number of steps designed to maximise competition and the quality of bids received. The main steps in competitive tendering are as follows, and each will be described in turn in the sections below:

- The request for tender
- Creating competition and maximising vendor participation
- Evaluation of tenders
- Contract negotiation and award.

The roles involved are summarised in Table 4.3.

The request for tender (RFT)

Once the procurement plan is complete, the information is assembled into an RFT. This document provides all the information that interested entities need to decide whether they are interested in bidding, and to prepare their tenders, such as:

- Goals and objectives of the procurement
- Contract duration
- Contract type
- Scope of services required
- Payment criteria
- Proposal evaluation criteria
- Contract monitoring
- Dispute resolution
- Proposal format
- Contract clauses, legal notifications and certifications
- Instructions to bidders (*e.g.* where to submit tenders, who to contact with written questions, etc.).

Most of this information will come directly from the procurement planning process. Note, however, that the cost estimate is not provided to bidders, since it will be used in the evaluation process to assess the reasonableness of tenders. This information should be treated as confidential, and access to it should be

limited to participants in the procurement planning and tender evaluation processes.

Creating competition and maximising vendor participation

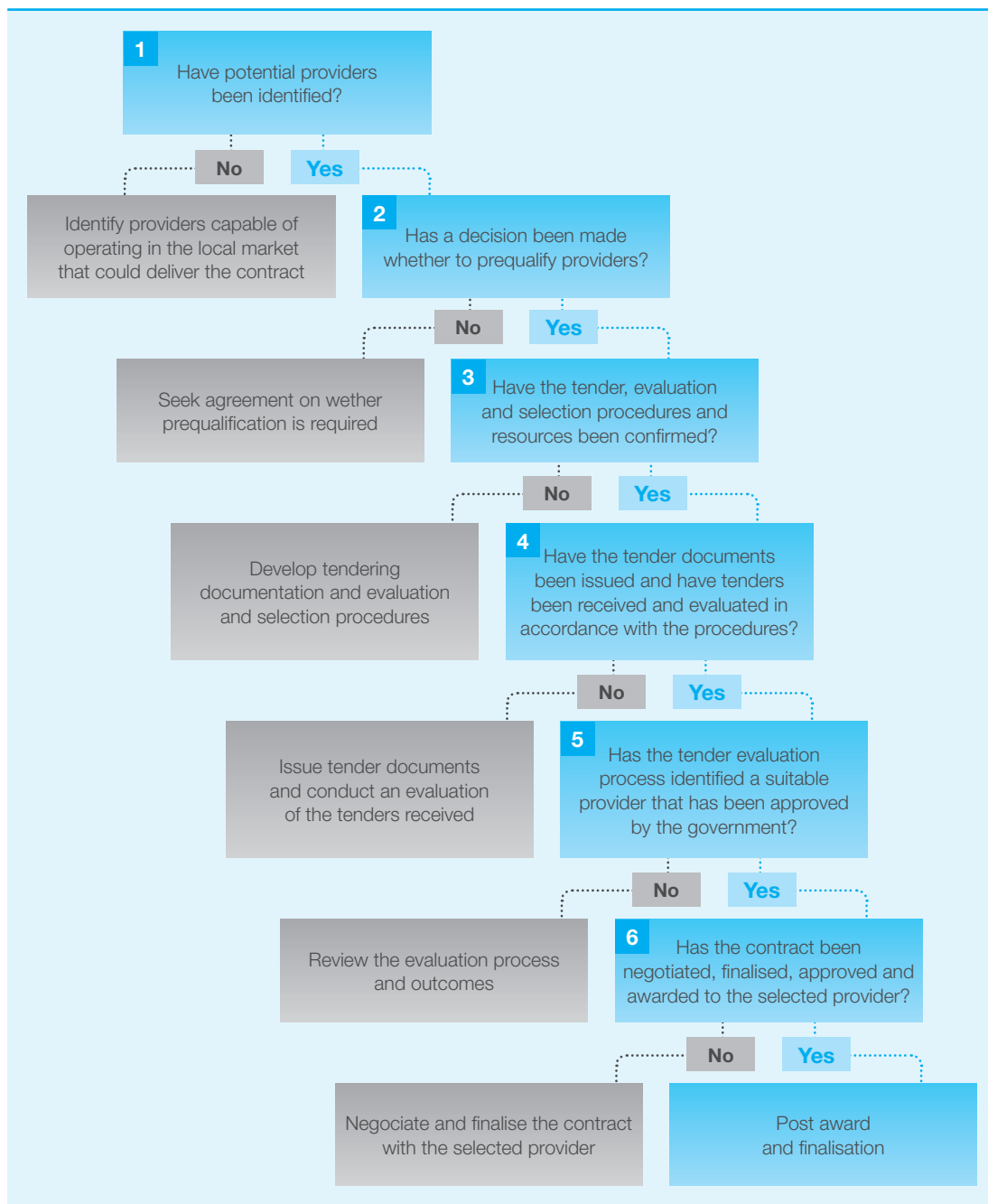
In a competitive procurement, the RFT should be advertised so that it can reach qualified bidders. It can be announced in local newspapers, on the radio, on the government website, or at public meetings. If the government has existing information about relevant service providers, it can also send copies of the RFT directly to them. However, this should be done in a fair and objective manner, ensuring that all known providers are targeted.

If there are likely to be suitable firms or other entities based outside the country, the partner government should consider advertising the RFT in international trade journals. If the government has engaged a technical adviser to assist in the procurement process, the adviser can help to identify appropriate publications likely to reach the partner government's intended audience.

Figure 4.3 shows how competition can be ensured while minimising transaction costs through a two-step process: (1) Organisations initially submit concept papers or qualifications statements; then (2) those who appear most qualified, based on a documented evaluation process using objective criteria, are invited to submit full proposals for final selection and contract award. For bidders, this process limits the initial investment needed up front and usually ensures a larger number of interested parties and proposals. They will only have to increase their investment of time or resources once there is definite interest in their proposed approach.

If there is a large number of potential bidders for a contract, the transaction costs for both the partner government and the private sector are increased

Figure 4.3. Decision tree: competitive bidding



(i.e. the costs of preparing and evaluating tenders). In the long run this can deter competition, because bidders will decide not to incur the costs of tender preparation if they think they are unlikely to be successful. The two-step process described above can be a useful approach for encouraging competition while minimising transaction costs.

If the supply market is not well understood, releasing a copy of the RFT before the formal invitation and inviting comments can be very useful, as can the use of briefing sessions. The feedback received from this approach can be useful in refining the documents and developing a better understanding of delivery mechanisms and likely costs (market analysis/intelligence). Equally important is the opportunity for vendors to ask questions and receive responses after the RFT is released. All questions and answers asked by potential bidders should be released to all vendors, so that all parties are working with the same information.

Evaluation of tenders

Tenders typically include a technical proposal and a cost proposal. The technical proposal outlines the asset or service to be delivered, while the cost proposal outlines the bidder's proposed cost or price for providing the services or functions.

Technical proposal

The partner government should form a tender board to review the technical proposals received. Typically, the board will consist of three or more people, but should not be so large that decisions are prolonged. The board members should have the technical expertise to evaluate the proposal subject matter. Importantly, board members should be free from conflicts of interest – such as a financial, family or personal interest in potential bidders. The board members should also be required to identify any conflicts of interest which become apparent once the proposals are received. If a conflict of interest is identified, the affected board member should be replaced.

The evaluation of technical proposals should strictly follow the evaluation criteria identified in the RFT. Each board member should prepare a written report of their evaluation of each proposal, preferably using a standard form or template prepared for this purpose. This helps to ensure consistent, objective evaluations. The evaluation forms are usually kept after completion of the evaluation and contract award to record how the evaluation was conducted and justify the contractor's selection. All bidders, both foreign and domestic, should be treated equally in the evaluation process.

The technical evaluation is based on the combined evaluation of the board members. If no proposal is found to be technically acceptable, the official managing the procurement process may write to each bidder outlining the shortcomings in their proposal, and give them an opportunity to submit a revised proposal. The evaluation board can then review the revised proposal following the steps described above once again. Alternatively, the procurement official may re-tender a revised RFT which makes the partner government's requirements clearer or more readily attainable.

Cost proposal

Submitted cost proposals are initially reviewed to ensure that they are fair and reasonable. Typically, this review is conducted by a different team of evaluators from the technical proposal, so that cost cannot influence the technical assessment. The assessment involves comparing the proposed prices proposed with the government's own cost estimate for the required services. Proposals which are significantly higher or lower than the government's estimate should be examined very closely before being evaluated.

A cost proposal which appears unrealistically low may indicate that the bidder does not understand the requirements of the RFT, or has omitted some of the requirements in preparing their costs. The procurement official may ask the bidder to confirm, in writing, their understanding of the requirements, and give them an opportunity to revise their cost

proposal. Cost proposals which remain unexpectedly low, without satisfactory explanation, can have a higher risk of non-performance, and should probably be excluded from consideration.

Cost proposals which are significantly higher than the government's estimate are also cause for concern. The contracting official can ask the bidder to confirm, in writing, their understanding of the requirements, and give them an opportunity to revise their cost proposal.

The contract is normally awarded to the technically-acceptable bidder with the lowest realistic cost, or at least the one offering the most feasible value for money. If there is no technically-acceptable proposal at a reasonable cost, the partner government must decide whether to re-tender a revised RFT which requires less costly services or is more technically feasible. This may be done by various methods:

- Making the performance standards easier to achieve.
- Limiting the geographic scope of the contract to the highest priority localities.

- Making a structural change – such as breaking a nationwide contract into several regional contracts – may allow smaller-sized bidders to reasonably compete (see Box 4.4 for an example). Note, however, that managing multiple contracts may increase the government's contract administration costs.

- Seeking written input from the bidders on how to reduce the cost of service.

- Reconsidering the idea of contracting out altogether, particularly if the cost of the contracted service appears likely to be unacceptably higher than direct provision by government of a similar service.

For more complex services, award may be made on a “best-value” basis. In determining best value, both the technical evaluation and the costs are considered using a weighted formula. A bidder who offers a significantly higher level of service or significantly less risk of non-performance at a slightly higher price may offer best value to the partner government.

4.5. Finalising and monitoring the contract

Once a bidder has been selected, the contractual arrangements must be agreed between the parties. The contract will reflect many of the key terms of the RFT, such as the scope of works, contract duration, performance standards and monitoring. Chapter 5 provides further information on contractual terms, as well as the negotiations between the parties in finalising the contract.

Once the contract is finalised, it is awarded to the chosen bidder. It is important that the partner government then announce the contract award publicly

and notify the unsuccessful bidders that the tender process has been completed. Announcing the contract award not only provides transparency, it also informs the community that arrangements for the delivery of services are underway.

At this stage, the main considerations are now:

- Monitoring and evaluation
- Integrating users' needs and lessons learned
- Government's contractual obligations
- Government's role at the end of the contract.

Table 4.3. Typical roles for competitive tendering and contract award

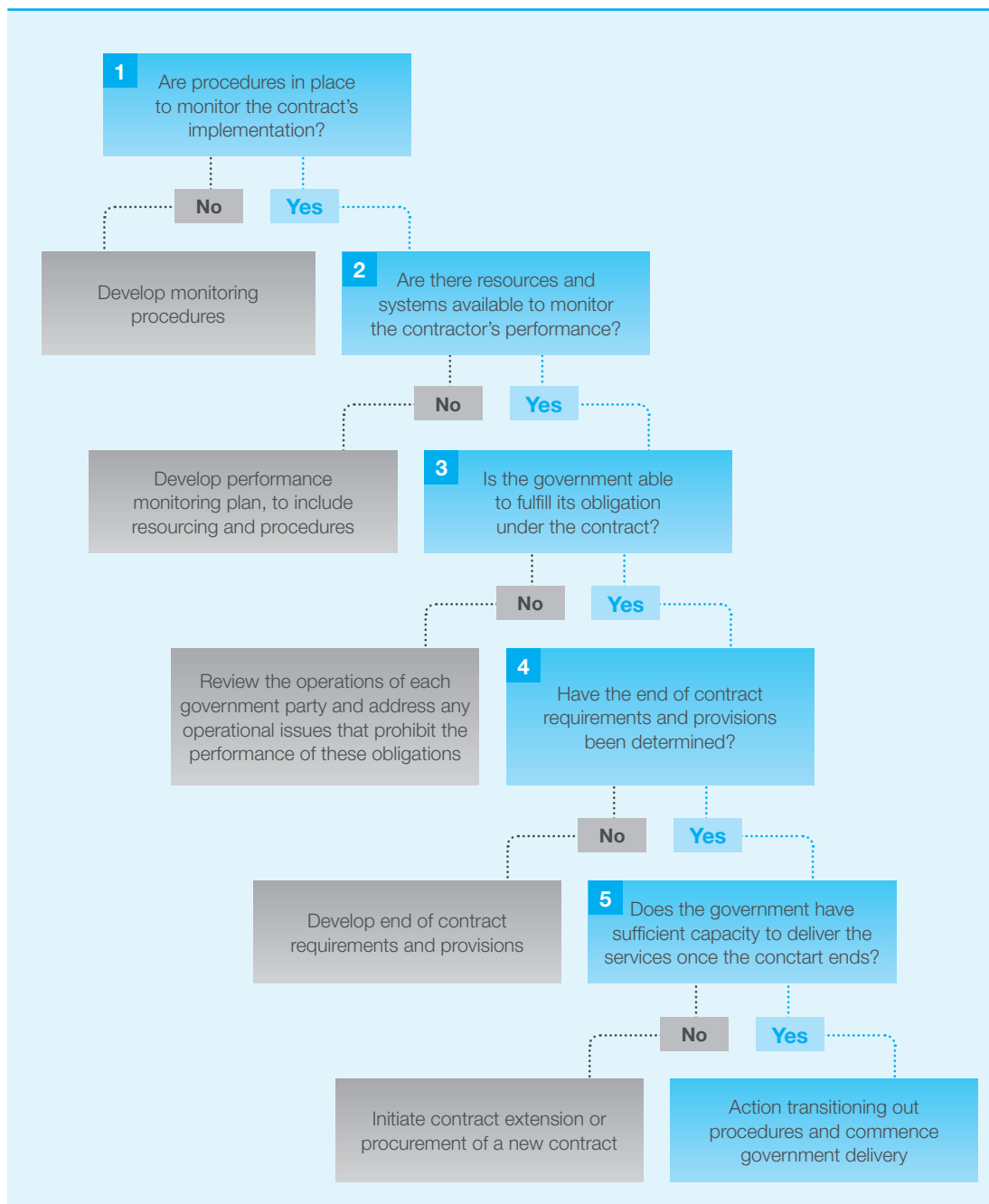
Role	Responsibility
Head of contract user / technical department	Identifies required capacity and assesses contracting approach
Project manager / technical staff	Approve procurement requests, within the limits of approved budgets, proposing amendments to existing contracts, if necessary, and assisting in technical negotiations.
Technical staff	Draft specifications and terms of reference, suggesting sources for delivery; help with the evaluation of bids.
Head of finance department	Confirms adequate funding availability against contract. Assists in estimating contract cost.
Head of procurement service	Plans, co-ordinates and monitors procurement activities for the implementing organisation.
Procurement staff	Supervise compliance with rules and procedures. Process valid procurement requests, checking RFT for completeness and plausibility. Keep procurement files up-to-date, draft tender documents, and collaborate with technical, legal and finance services. Assist in bid openings/evaluations, prepare award decisions and provide advice on rules and procedures. Create financial commitments by establishing contracts.
Legal adviser	Provides legal advice on contracts and assist in negotiations.
Tender evaluation committee and tender board	Evaluates proposals and prepares evaluation report. Higher-value contracts are typically submitted to a separate tender board for approval.

Monitoring and evaluation

Once the contract is in place, the partner government is still responsible for ensuring that the services are delivered as required under the contract. If the capacity exists, the government needs to monitor and evaluate the service contractor's performance directly (Figure 4.4). If the government lacks this capacity, the task can be performed by an independent verification agent (requiring a separate procurement and contracting exercise). Typical roles for this phase of the procurement process are displayed in Table 4.4.

Regardless of whether monitoring and evaluation are performed by government staff or by a separate contractor, they include:

- Collecting objective, quantified and well-documented information on the contractor's performance against the contract's standards (see Box 4.3 for an example). This may include examining completed work, reviewing contractor's records and reports, and conducting customer interviews or surveys. It is not necessary to conduct a full review of services performed – a sampling methodology can be used instead as long as it provides a representative picture of the contractor's performance. For example, if a contractor is to provide health services in a region which includes both urban and rural communities, data should be collected on service delivery to both urban and rural customers. A statistically-sound random sampling methodology can help the government reduce the cost of performance evaluation. There are usually

Figure 4.4. Decision tree: post-award and finalisation

two phases of data collection: (1) contract mobilisation; and (2) performance. Typically, contract mobilisation is a short, or one-off, data collection exercise (*e.g.* to find out whether the health clinic(s) opened as scheduled and were equipped with trained staff). Data collection on contract performance, however, is an on-going process which will occur over the life of the contract.

- Evaluating contract performance data. This is done by comparing the performance data with the contract performance standards. The evaluator should not take into account any poor performance due to circumstances beyond the contractor's control, such as natural disasters, civil disturbance or failure by the partner government to meet its obligations under the contract. Typically evaluation is done periodically (*e.g.* monthly) and the period should be stated in the RFT.

Box 4.3. Afghanistan: involving stakeholders in monitoring health services

Shortly after the fall of the Taliban regime, Afghanistan's Ministry of Public Health (MOPH) pursued a strategy to rebuild its services as well as to contract NGOs to provide a basic package of health services (BPHS). The MOPH developed a balanced scorecard (BSC) to regularly monitor the progress of the BPHS. In design workshops, six domains were identified for incorporating into the BSC: patient perspectives, staff perspectives, capacity for service provision (structural inputs), service provision (technical quality), financial systems, and overall vision for the health sector. For these domains 29 indicators and benchmarks were then developed. Nationally, health services were found to be reaching more of the poor than the less-poor population, and providing for more women than men, both key concerns of the government. However, serious deficiencies were found in five domains, and particularly in counselling patients, providing delivery care during childbirth, monitoring tuberculosis treatment, placing staff and equipment, and establishing functional village health councils.

According to the authors (see below), the BSC has proved to be a useful tool for the MOPH, NGOs,

and other stakeholders, and has become one of the cornerstones of the government's monitoring and evaluation system. It has provided a platform for standardising the monitoring of results across different donor, NGO, and government health-care providers, allowing MOPH to be a more useful steward of the health sector. The development and use of the BSC have become central to a systematic effort to build the capacity of the MOPH, with a phased transition of responsibilities from technical assistance to the government.

The BSC has also helped stakeholders to focus on particular provinces, as well as on specific areas for improvement. NGOs are also using the scorecard as an objective assessment and for informing their decisions, and its findings are incorporated into decisions on performance bonuses and continuation of contracts. However, the report also identifies a number of limitations of the BSC, including the fact that it has relatively little information on health service coverage or health status outcomes, and that the BSC is only measured at functional health facilities, and thus does not take into account places where the BPHS is not being provided.

Source: Peters, D. *et al.* (2007), "A Balanced Scorecard Approach for Health Services in Afghanistan", Bulletin of the World Health Organization, February, 85:2, World Health Organization, Geneva

Integrating end-users' feedback and lessons learned

It is important to consider feedback from the end-users of the service as well as from other stakeholders (see Box 4.3). Whilst helping to evaluate contract performance, the feedback process can also gain users' support and increase their awareness that the service is ultimately being provided by the partner government. Feedback can be acquired in many ways, including face-to-face contact, phone or e-mail exchanges, surveys, users' scorecards or other tools. In gathering user feedback, it is important to seek responses that help determine whether the contractor has met the requirements of the contract rather than the users' expectations. This is essential for fairness and to foster accountability between the partner government and its contractor as well as between end-users (citizens) and their government or local authority. Often users' expectations will be based on their individual circumstances and may differ from the contract performance standards. User feedback is also useful in deciding to extend or re-tender a contract.

It is also important to identify and document lessons learned during the procurement process after the contract has ended. These can be used to refine subsequent procurements, and can provide significant and unexpected findings, as shown by another recent experience in Afghanistan (Box 4.4).

Fulfilling government's contractual obligations

Another key role for government is to pay the contractor in accordance with the payment mechanism outlined in the contract. To meet these obligations, government must have a payment system to ensure secure and timely payments. If payments are not made on time, the contractor may have grounds to halt the provision of services until payment is received. This is because the contractor invoices the government or seeks payment after it has provided the services and has incurred the costs in delivering

these services. If payment is not received on time, the contractor may not be inclined, or able, to continue to incur further costs.

The government may also have other obligations under the contract, such as providing land, equipment, facilities, permits or statutory approvals to the contractor so that they can deliver the services. It is critical that the government meet these obligations. Failure to meet them will delay the delivery of services and may also cause the contractor to withdraw from the contract. The contractor may also seek compensation if the government's failure to comply with contractual obligations led to financial or reputational damage to the contractor.

>TIP: The government can ensure it can meet its contractual obligations by preparing for them before the contract is awarded.

Deciding the next steps

While the contract services are being delivered, government can also build its own capacity so as to be able to provide the services itself once the contract ends. Towards the end of the contract, the government will need to assess whether its capacity is sufficient to undertake this role. If it is, then provisions will be needed to return the services from the contractor to the government at the end of the contract period. If the government's capacity is not considered suitable to deliver the services or if it seems that better value for money is achieved by contracting out (while minimising risks, as described in Chapter 2), then the services will continue to be contracted out. Under this scenario, the government will need to either extend the current contract or re-tender the contract. Re-tendering will enable the government to revise contractual arrangements, including the scope of work and performance standards, if its needs have changed since the initial contract was tendered or on the basis of lessons learned in the current contract period. These decisions must be made before the end of the contract so that there is adequate time to plan for their successful implementation.

Box 4.4. Afghanistan: procurement for roads

A 2005 review of major road projects implemented in Afghanistan revealed some key issues and constraints for obtaining value for money, adequate accountability and transparency. First, all projects incurred higher-than-expected security costs (3-15% of total project costs). While there were also other problems, such as poor weather conditions, security was a major constraint for project implementation and value for money (with further implications for delays, safety of personnel, etc.). Second, the price, availability and quality of supply (often imported), also raised unit costs. For example, unit costs for asphalt pavements were estimated to be 30-45% higher than in neighbouring countries. Third, lack of participation by the Afghan

private sector in bidding processes somewhat reduced competition, increased costs and lowered quality. Their constraints include lack of experience in managing large-scale projects and in following donors' financial management and procurement processes; lack of up-front capital (or financing) to mobilise equipment; and difficulties in mobilising construction labour. Fourth, many of the projects were contracted with limited competition. Other factors also contributed to higher unit costs. For example, it was noted that implementation delays occurred because of government red-tape, for instance to clear the importation of equipment. The review also found major variations in unit costs, from USD 123 000 to USD 589 000 per km of road.

Source: World Bank (2005), Afghanistan, Managing Public Finances for Development, World Bank, Washington DC

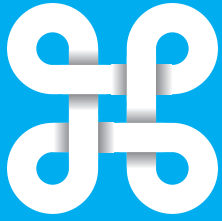
Table 4.4. Typical roles for finalising and monitoring

Role	Responsibility
Head of contract user / technical department	Assesses service delivery against contract requirements in a monitoring and evaluation framework.
Project managers	Monitor and evaluate service delivery. Propose amendments to existing contracts.
Technical staff	Check and endorse or correct invoices against signed contracts and progress of works/delivery.
Procurement staff	Take contractual action if performance problems exist. Process contract modifications and close-out.
Head of finance department	Supervises accounts and cash flow.
Budget service	Sets up budgets according to signed project documents; processes budget revisions (budget line transfers) as requested by project managers and approved by funding agencies.
Payment service	Checks invoices against contracts and related financial commitments and processes endorsed invoices.
Legal adviser	Provides legal advice on contracts and in cases of disputes or claims.

Useful resources

Guidance on good practice in procurement

1. Beth, E., Bertók, J. and Vergez, C., 2007, 'Integrity in Public Procurement: Good Practice from A to Z', Organisation for Economic Cooperation and Development, Paris
www.transparency.org/content/download/25625/386056/file/Integrity+in+Public+Procurement.pdf
 This publication identifies good practices adopted around the world to promote integrity in the whole procurement cycle, from needs assessment to contract management.
2. World Bank – Procurement
<http://go.worldbank.org/9KQZWXNOI0>
 Information on procurement guidance, public procurement systems, policies and procedures, and monitoring and reporting. This guidance relates primarily to World Bank financed projects.
3. OECD, 2006, 'Methodology for Assessment of National Procurement Systems', Version 4, July 17, OECD, Paris
<http://www.oecd.org/dataoecd/1/36/37130136.pdf>
 An assessment methodology for developing countries and donors to assess the quality and effectiveness of national procurement systems.



Chapter 5

Legal issues:
contracts between
government and
service providers

What's in this chapter?

This chapter provides information and tools for partner governments, contractors and other stakeholders for developing and implementing the legal aspects of contracting out government functions and services. This chapter includes:

- > Guidance for ensuring that legal aspects are considered throughout the contracting process.
- > Steps for ensuring that contracts are legally binding and enforceable.
- > Guidelines for drafting contracts that will achieve government and stakeholders' goals.
- > Information on how best to enforce contracts and on how to resolve disputes between the parties.

Key lessons learned

- > In most cases contracts for providing government services should be as formal and complete as possible. Contracts should have the elements and terms necessary to be enforceable. However, in some cases, more informal and incomplete contracts are acceptable, such as when a contract for services must be completed quickly in a dynamic situation, when there is little capacity to develop a formal contract, or there is a long-established relationship between the parties.
- > The government should negotiate contracts for services based on a strategy that ensures the best value for money for citizens, that the government's capacity will be developed, and that there are adequate mechanisms for monitoring and enforcement.
- > Key terms must be included in a written contract, including the scope of work, price, payment, duration, monitoring mechanisms, termination, modification, and dispute resolution. Financial arrangements should be identified and specified in the contract and/or in a separate agreement, such as a guarantee or bond.

5.1. The legal implications of contracting out in fragile states

Although the parties will usually sign contracts at the end of the tendering process, legal issues relating to the contract need to be considered early on and throughout the entire tendering process, as summarised in Figure 5.1. Teams working on procurement should work hand-in-hand with those drafting contracts.

Chapter 3 discusses the need to assess the enabling environment and the organisational and leadership capacities before deciding the government's role in contracting out. As part of this enabling environment, the legal framework determines the types of contracts that can be offered and guides the terms and conditions that will be needed within the contract. Organisational and leadership capacity are also relevant to the negotiation of contract terms and monitoring, and the regulatory mandate determines who will regulate and what regulatory and enforcement provisions are needed in the contract.

Ideally, a country will have a legal framework comprised of a number of laws that enable contractors to provide government services (Box 5.1).

However, we have already seen in Chapter 3 that not all governments have sufficient capacity to contract out services – they may lack the institutions, systems, personnel and legal framework necessary to develop, negotiate and oversee contracts. This is often a problem in fragile states, where government capacity may have been damaged by war, natural disasters or other disruptions. As discussed in Chapter 3, if a fragile state has a poor enabling environment, it will be an important priority for the government to take steps to strengthen it (as in Case Study 11, below). In the meantime, a poor enabling environment can be compensated for through a number of means: contractual terms can be adjusted, laws of other countries can be used, and deficiencies in administrative structure and regulatory capacity can be provided through contracting out administration and regulation. Where there is no capacity to contract out services, the government can contract out the procurement function itself (see Case Study 6 in Chapter 3).

Figure 5.1. Key stages of procurement and their legal implications

The enabling environment	→	Pre-tendering	→	Competitive tendering	→	Post-award
<ul style="list-style-type: none"> • Ensure adequate legal framework • Assess organisational and leadership capacities • Strengthen regulatory and policy framework 		<ul style="list-style-type: none"> • Identify needs and objectives • Select contract and payment type • Develop scope of works and contract documentation • Develop procurement plan 		<ul style="list-style-type: none"> • Prepare tender documents • Evaluate tenders and select provider • Negotiate the contract • Draft and sign final contract 		<ul style="list-style-type: none"> • Monitor implementation • Evaluate performance • Fulfil contractual requirements, including payments

Box 5.1. An enabling legal environment for contracting out government services

- **Specific laws providing for contracting out government services** can create a framework to determine the parameters and requirements of the contract and allow contractors to be accredited. Some, but not all, countries have such laws.
- **Procurement laws** or other laws dealing with public contracts provide the rules for the acquisition of goods and services by government. These laws often include requirements such as compliance with state laws and grounds for termination, and prohibition of certain acts such as hiring of government employees by the contractor. The law should promote transparency, open competitive tendering, fair competition and clear evaluation and selection (see OECD, 2006b for detailed guidance). The United Nations Commission on International Trade Law (UNCITRAL) has developed the UNCITRAL Model Law on Procurement of Goods, Construction and Services. Laws based on this model law have been adopted in various countries including: **Afghanistan, Albania, Azerbaijan, Bangladesh, Croatia, Estonia, Gambia, Ghana, Guyana, Kazakhstan, Kenya, Kyrgyzstan, Madagascar, Malawi, Mauritius, Moldova, Mongolia, Nepal, Nigeria, Poland, Romania, Rwanda, Slovakia, Tanzania, Uganda, Uzbekistan and Zambia.**
- **Regulations and procedures for procurement** are necessary to provide guidance on how to apply the law to specific circumstances. They should be updated regularly and be easily available to the public. Model tender documents or standard and mandatory clauses are helpful to promote competition. Many countries also have manuals to guide government contracting entities. Regulations should include procedures for commitment of budget funds and standards for processing invoices.
- **Contract laws** provide requirements for the creation, interpretation and enforcement of contracts. These laws are sometimes contained in a civil code, or are in a separate law on contracts and obligations.
- **Enforcement laws** provide procedures for enforcement of contracts (collecting money owed or requiring performance of certain acts). They are usually found in a law on civil procedure or on enforcement of judgements.
- **Laws and regulations regarding standards**, including for product quality, health and safety, labour, accounting and financial, and other standards. International treaties and standards may also be applicable, and can be found in global, regional and bilateral trade agreements or international standards such as the International Accounting Standards.
- **Laws relating to business organisations and NGOs** set out the types of for-profit and non-profit organisations that can be set up in a country and how they must operate. They are usually found in a company law, law on organisations, law on non-governmental organisations, etc. There may also be specific laws for certain types of service providers. For example, in the **Philippines**, the Co-operative Code allows for public service co-operatives that “render public services as authorised under a franchise or certificate of public convenience and necessity duly issued by the appropriate governmental agency.” Co-operatives set up under this law include water service co-operatives that own, operate and manage water systems.

- **Trade laws**, including national laws on foreign trade and competition, and global, regional and bilateral trade agreements. National trade laws include laws and regulations on trade, customs, transport and tariffs. Trade agreements often prescribe when and how foreign firms can operate in and trade with a country and compete for government procurements.
 - **Property laws**, including laws relating to immovable and movable property ownership, intellectual property rights and foreign ownership.
 - **Laws regulating technological transfers** including laws and regulations that restrict certain technology transfers, provide for licensing of technologies and guide technology transfer agreements.
 - **Laws protecting private information** include laws relating to data privacy (where identifiable data relating to individuals and organisations are collected and stored), financial privacy (relating to assets, liabilities, transactions, etc.), medical privacy (regarding medical records, information, or data), political privacy, and trade secrets. The laws relating to individuals will be relevant whenever data and information are being collected or used. The laws relating to businesses and NGOs will often help to prevent a specific contractor's competitors from unfairly competing with them by protecting the contractor's trade secrets and financial information.
 - **Financial laws** – including laws defining financial relationships, lending and secured transactions – provide the legal framework for borrowing, lending, and structuring financial transactions. These laws guide what types of financing arrangements a contractor can make.
 - **Specific laws relating to the sector.** For example, in many countries the activities of non-state justice providers are incorporated into the law governing courts and justice (OECD, 2009c). There may also be licensing requirements for certain economic sectors and professions.
- Copies of these laws, regulations, international agreements and treaties can be obtained from a variety of sources, including the government (e.g. ministry of justice), the legislature (parliament), law schools, bar associations and international sources such as World Bank Doing Business,¹ FindLaw² and the United Nations Treaty Collection.³ Annex A provides a list of trade agreements and regional structures relating to procurement. Laws and regulations, particularly those relating to government procurement, should be easily accessible to the public at no cost. In addition, many governments issue financial management instructions that dictate how public servants manage contractual processes.

1. See www.doingbusiness.org/LawLibrary.

2. See www.findlaw.org.

3. See <http://treaties.un.org>.

Case Study 11. Developing a new procurement law in Afghanistan

Afghanistan enacted a number of procurement laws from 1987 onwards. While these laws were generally antiquated and confused, they did at least provide the basic concepts of a good procurement system involving competition. In 2003 the Afghan government agreed on the need for a modern procurement law that was clear, promoted competition, improved accountability and transparency, and could address corrupt procurement practices effectively.

A number of iterations of the law were developed by international advisers; it was finally approved by the cabinet in 2005. Subsequently the necessary accompanying regulations, handbooks, operational procedures and standard contracts were created and the official bodies required under the law were established. Creation of a Procurement Policy Unit in the Ministry of Finance in 2007 represented an important step forward to take the lead in preparing detailed regulations, overseeing training and monitoring procurement performance.

Adoption of the new law was limited initially to those ministries in the capital, Kabul, with higher levels of capacity. It wasn't until 2009 that it was widely adopted by all ministries in Kabul. However, application of the new law and regulations continues to be very limited at the sub-national level due

to very significant capacity constraints and difficulties in delivering effective training.

Overall, progress in developing, approving and implementing the new law has been slow due to poor government ownership and the lack of a clear champion in the government. Low capacity and misunderstanding of the scope of the procurement function (e.g. there is a belief that only major works or purchases are "procurement") were also significantly detrimental to the pace of the reforms.

Lessons learned: While a modern procurement law is necessary to facilitate the contracting out of government functions and services, many other factors are needed for procurement to be effective. These factors include:

- A person who can champion the building of procurement capacity and clear leadership within the government.
- Education throughout the government, including local government, on the importance of a procurement law.
- Holistic and flexible human resource development, including formal training in procurement, augmented by on-the-job training and mentoring.

In the absence of such laws, the contract itself should attempt to supply requirements that would normally be found in the laws. These terms should be consistent with national legal tradition and culture since they substitute for a national law. Alternatively, the requirements could be based on the laws of another country in the region or other major trading partner. In fact, the contract could provide that it should be interpreted under the laws of another country.

The **organisational and leadership capacities** needed to support contracts are discussed in Chapter 3. The guidelines set out in Chapter 3 will enable a contracting government to develop the capacities to monitor, regulate and provide oversight of contracts. As discussed below, the contract should include specific provisions establishing the regulator's authority. If the regulator does not have sufficient authority and capacity to regulate and oversee the contract according to its mandate, arrangements

should be made to develop them either within the contract for services or in a separate agreement with the contractor or a third party.

Before structuring and negotiating the contract, the government should also consider whether the

various constraints or disincentives discussed in Chapter 2 are present and what effect they might have on the ability to enter into, monitor and enforce contracts.

5.2. Ensuring contracts are binding and enforceable

As described in Chapter 1, a contract formalises an agreement between two or more parties. Contracts establish how and when the parties agree to perform certain activities. A contract should set out the parties' rights and responsibilities and should prevent unnecessary disputes by having the parties consider all issues in their intended relationship.

A contract can be written, oral or a mixture of both. However it is usually not advisable to rely on oral contracts; not all oral contracts are enforceable in all jurisdictions. It can be very difficult to prove that an oral contract exists or what its terms are. An oral agreement greatly reduces the transparency of the procurement process, which in turn increases performance risks, encourages corruption and makes it much harder to hold accountable those responsible for the contracting process. Many countries have a law, often called the "statute of frauds", that requires certain contracts to be in writing, including contracts with a duration of over one year.

In most countries a contract must have the following elements in order to be binding (creating a legal obligation) and enforceable (in court or arbitration):

- **"Meeting of the minds" (mutual consent):** The parties to a contract must have a mutual understanding of what the contract covers. For example, if the government wants a four-lane asphalt road to be built but the contractor intends to build a two-lane gravel road, there is no meeting of minds and the contract is likely to be

unenforceable. However, determining a meeting of the minds is based on an objective assessment of what the parties actually said and did and not what they claim was their unexpressed intention. Thus, if there is a dispute over the contract, a court or arbitrator looks at the communications between the parties and the actions and circumstances surrounding these communications.

- **Offer and acceptance:** A contract involves making an offer to another party, who then accepts the offer. For example, a service provider's proposal to give financial management assistance to a ministry is an offer. The ministry's acceptance of that offer is a necessary part of creating a binding contract for providing financial management assistance. A counter offer is not an acceptance, and will typically be treated as a rejection of the offer. For example, if the ministry responds to the offer with a lower price and different scope of work, this is a rejection of the original offer. If the service provider accepts the ministry's counteroffer, a contract may be completed.
- **Consideration (the mutual exchange of something of value):** To create a contract, the parties must exchange something of value. In the case of building a road, the government receives something of value (a road) and the contractor receives payment.
- **Performance or delivery:** A contract needs to describe what services or goods will be provided

and the standard/quality required. In order for a party to enforce a contract, it must have performed or delivered as promised in the contract. For example, if the contractor completes the road to specifications, it can enforce the contract to require payment of the agreed price. If the contractor does not complete the road, or does not provide a road that meets the technical standards specified, it cannot require payment.

Some other requirements for contract validity should be kept in mind. Each party must act in **good faith**, and not attempt to mislead the other party. In addition, in order to be enforceable, a contract must be for a **legal purpose** and not in violation of “public policy”. If the subject matter of a contract is illegal, the contract cannot be enforced. Thus, a contract for the sale of illegal drugs would not be enforceable – except, of course, through illegal means.

Informal versus formal contracts

An initial consideration of the government should be whether it needs to develop a formal and detailed

contract or something less formal and detailed (Box 5.2). Contracts can range from simple one-page agreements or purchase orders that list the parties, period of performance, services or goods to be delivered and price; to contracts with hundreds of pages of terms and specifications. This handbook focuses on formal contracts for services and goods, but we should note that governments use various types of arrangement. In addition, nearly all contracts have some degree of informality or incompleteness – it is difficult, if not impossible, for a contract to predict every possible circumstance in a relationship. The complexity or completeness of the contract⁴ is driven by several factors (Table 5.1).

4. A more complete contract takes account of many future contingencies that would change the value of performance – *e.g.* increases in the cost of inputs, decline in demand for the service, etc. A less complete contract might simply state the price and performance – *e.g.* deliver the medical devices on January 1, for USD x – without saying what happens if the product is destroyed in transit, for example.

Table 5.1. Factors that influence the complexity, completeness and formality of contracts

Complex or complete	Informal or incomplete
Complicated subject matter	Straightforward arrangement between government and contractor
Large value	Short duration
Lengthy period to develop and negotiate contract	Crisis that requires immediate performance of services
Sufficient government capacity to develop complex contract	Laws or regulations prescribe terms of the agreement
Greater certainty about future conditions and events	Court system can quickly, fairly and consistently interpret and enforce contract terms
New or complex relationship between the parties	Existing relationship between the parties

Thus, in fragile situations where information, the legal framework and the capacity to develop an elaborate contract are weak, the parties may enter into informal non-contractual agreements – in essence a non-written public-private partnership whereby both parties have similar goals (see Chapter 1 on mutual agreements). For example, in **Honduras** the national water authority works with community-based groups, including neighbourhood water boards, to provide water to marginal and informal settlements. The boards organise microenterprises to maintain infrastructure and manage delivery, while the local governments provide regulation, quality control and some technical support. All of the relationships and responsibilities are undertaken without formal contracts (James, 1998).

In other cases a government and contractor may have a written agreement which is incomplete, with many of the basic or key terms unwritten (*e.g.* price, timing). This may be the case when there is a history of co-operation between the parties or there are legal or institutional capacity limitations, such as weak legal frameworks, poor enforceability and insufficient processes and staff to develop

and oversee detailed formal agreements. In fragile states in crisis conditions where needs cannot be easily known or prioritised, governments will often find it necessary to have an incomplete contract. Thus, after a natural disaster or conflict a contract should allow for changing the terms as needed, *e.g.*, a contract for provision of primary healthcare in post-earthquake Haiti might provide for changes to the scope of work and payment as the services and recipients are better defined. In other cases an incomplete contract is desirable where the contract and/or relationship are based on mutual trust and a willingness to accommodate changing conditions (which is often the case in fragile states). For example, in Lusaka, **Zambia**, water and sanitation services are provided by Residents' Development Committees and the Lusaka Water and Sewerage Company through a combination of informal arrangements and formal contracts (Community Organization, 2000).

Annex C describes a variety of agreements between governments and private parties, some of which may be informal or incomplete.

Box 5.2. Using informal or incomplete agreements

In some situations it may be acceptable to use informal (oral and vague arrangements) or incomplete contracts (usually written but missing terms and conditions). For example, where:

- The parties have a long relationship with a high degree of trust, and there is little risk of corruption.
- The terms and conditions of the arrangement between the parties are established and well understood.
- The terms and conditions are difficult or costly to specify because of uncertainty of the future situation or variable circumstances in different geographic areas.
- The parties have a way to enforce or renegotiate agreements outside of courts or they must co-operate due to mutual dependencies or the need to preserve business dealings or reputations.

5.3. Drafting contracts: some guidance

The remainder of this chapter discusses the legal issues that governments need to consider in negotiating, drafting, monitoring and enforcing a contract. It also discusses how to ensure that the government receives appropriate capacity development so that in the future the services do not need to be contracted out.

Contract negotiations

As discussed in Chapter 4, the contracting process can use many procurement methods. If, for example, there is no time or capacity for a competitive process, the government may negotiate with a single firm. However, single firm (or sole source) negotiations should be avoided whenever possible, because the government faces much higher risks of corruption and loses the many benefits of competition. Alternatively, if the government has developed a mature set of specifications for a required good or service, it may wish to encourage vigorous price competition by having vendors bid on price against those specifications. Finally, if the government is unsure of the likely scope of work or the technical solutions available in the market, the government may wish to enter into structured negotiations with potential vendors. Not all procurement regimes allow these types of competitive negotiations; they are complex, and raise significant risks of corruption and discrimination because they vest so much authority in contracting officials. Structured, competitive negotiations do, however, allow governments to take advantage of limited competition, while exploring the innovative technical approaches available from various vendors across the market.

>TIP: Structured, competitive negotiations allow governments to take advantage of limited competition, while exploring the innovative technical approaches available from various vendors across the market.

Whether conducted with many vendors or just one, negotiations consist of a dialogue intended to clarify requirements, resolve disputes and produce an agreement. If a tender is competitive, negotiations will take place after a preferred bid is selected and before the contract is signed. If it is non-competitive it will take place right after the scope of work is determined – the “defining and initiating the contract stage” described in Chapter 4. During a negotiation, the parties put forward and discuss all of their objectives, positions and interests to reach a shared final decision that all will benefit from. Negotiation requires careful preparation and includes the following steps (having first considered the issues listed in Box 5.3):

1. Government prepares a draft contract for review by one or several competing vendors following the steps outlined in Chapter 4. As discussed in Chapter 4, in most cases the government will select a preferred bidder to negotiate with, but sometimes it will be advisable to enter into negotiations with more than one bidder.
2. Certain contract terms are negotiated between the government and the preferred bidder. The terms are usually limited to a few specific technicalities, but may involve more extensive discussions of different technical solutions (if, for example, the government has described its needs but not a specific method for achieving them).
3. The terms of reference are discussed and clarified.
4. Parties attempt to rectify any issues threatening the contractor’s ability to perform as specified, such as a changing the timing of service delivery or the loss of a key person included in the bidder’s proposal.

5. If the purchaser is not able to reach agreement with the leading bidder after negotiations in good faith, the purchaser may terminate negotiations and begin discussions with the second highest-ranked bidder.
6. Once agreement has been reached the contract is signed by the parties and the steps outlined in Chapter 4 are followed.
7. Throughout the process the parties keep a record of negotiations. The results of the negotiations should be captured in the final contract or in negotiation minutes that can be referred to in the contract. The contract should be explicit as to whether documents generated during the contract formation process (such as the successful vendor's proposal) are to be considered part of the contract's binding terms.

Box 5.3. Issues to consider in preparing for contract negotiations

- What is the goal of the contract?
- Does the government have the capacity to provide this function or service in-house? If so, can it do it more cost-effectively than contracting out the service or function?
- What is being contracted out?
- Are there local providers or contractors able to provide this function or service or does the government need to look outside the country?
- When do the services need to be completed or the goods delivered?
- What quality of services or goods is required?
- What are the best payment terms for this type of contract?
- What are the performance indicators and how will results be measured?
- Who will monitor performance?
- What rights are needed with regard to performance, monitoring, enforcement, etc.?
- What are the non-financial risks of the contract to the government and to the contractor?
- What will be the payment mechanism?
- What is the level of risk inherent in this payment mechanism to both the government and the contractor?
- What government capacity is needed to oversee the contract?
- How and by whom will disputes be mediated or arbitrated?
- Does the government wish to build into the contract an element of capacity development or would it be better to negotiate a separate contract for this?
- What government capacity is needed to oversee the contract?
- How and by whom will disputes be mediated or arbitrated?
- Does the government wish to build into the contract an element of capacity development or would it be better to negotiate a separate contract for this?

The **approach to negotiating** will often influence the time it will take to negotiate and the outcome. Negotiations can become complicated given the broad range of interests among many actors, including national governments, INGOs and local NGOs, commercial sector entities, end-users, and even international donors, all of which have different agendas (see Chapter 2).

The following basic guidance on negotiations can help:

- **Prepare carefully for the negotiations.** Before beginning contract negotiations and/or drafting, each party should think through its objectives and strategies for negotiations and consider the terms they need to include in the contract. The government's objectives should match citizens' (or specific end-users') interests. In considering objectives and priorities, the government should also consider its past experiences with contracting out and other forms of collaboration and incorporate these lessons into its approach.
- **Consider the style of negotiations that the parties want.** There are various approaches to negotiation and the appropriate approach depends on the country's culture. But some approaches seem to have consistently good results. An approach that focuses on each party's interests (what they need to have in the contract) rather than its positions (what they are demanding to have in the contract) helps both sides to develop solutions that are based

on objective criteria and are mutually beneficial (Fisher and Ury, 1983). Their possible interests are outlined in Chapter 2 and summarised in Box 5.4.

- **International negotiations are different.** International business negotiations require an approach that recognises the differences in business cultures throughout the world (Requejo and Graham, 2008). Taking time to research the culture of the other party will help to develop realistic objectives and a negotiation strategy that will be more likely to succeed in meeting the parties' objectives. Understanding a party's own cultural values (that influence how they interact with others, make decisions and determine what is wrong and right) will help to decide when to stand firm and when to compromise.
- **Be aware of the other party's negotiation style.** Once the negotiations start, each party should ask a lot of questions to help them understand the respective objectives and interests of the other party and persuade them to adopt the desired objectives. It will also help each party to identify the other party's negotiation style. One author has identified five negotiation styles or responses (Shell, 2006): **accommodating** (tries to solve problems and preserve relationships); **avoiding** (does not like negotiating); **collaborating** (enjoys negotiations and creative problem solving); **competing** (enjoys negotiations because they present an opportunity to win something); and **compromising** (eager to close the deal by doing what is fair and equal).

Box 5.4. Parties' general interests

The parties' general interests could include:

- **Government:** To provide quality services to citizens at the lowest possible price.
- **For-profit contractor:** To increase profits, effectiveness and market penetration.
- **Non-profit contractor:** To fulfil a social mission, to sustain themselves financially, and to gain recognition from the government and end users.

In most cases all parties will want to retain **legal and other advisory services** to assist with negotiating and drafting the contract. Sometimes the government may have in-house lawyers who can develop the contract. In other cases the government will need to use external lawyers to provide the necessary expertise. Often local lawyers and law firms will have this expertise, but if not, the government will need to obtain specialist legal services from outside the country. Governments might have or may consider setting up panel arrangements whereby law firms are appointed to a legal services panel, entitling them to provide legal services to the government. If the contract and subject matter are similar to arrangements that have been contracted in the past and the agency has non-lawyer personnel with experience in the contracting process, it may not be necessary to have a lawyer negotiate and draft the contract. Over time, standardised contract terms may be developed by the government, and may even be incorporated into the procurement regulations. Other advisory services that might be needed include financial and technical consultants to help structure more complex arrangements.

Hiring private lawyers may also require a competitive bidding process under procurement law. Whether or not the bidding is required to be competitive, the government agency will need to target lawyers with appropriate expertise and experience and should get multiple quotes. The lawyers will need to have experience in negotiating and drafting government contracts for outsourced services and should also have experience in the sector that is the subject of the contract. There are many information sources for finding lawyers – especially on the Internet – and some fragile states will have their own reliable sources, including their national bar association. If there are no reliable sources, it is best to competitively procure domestic legal services and obtain references and examples of the lawyer's previous work on government contracts. There are sources for obtaining contacts for qualified international lawyers (Annex A), but again it may be advisable to competitively procure these services. Donors also may

provide legal and other professional assistance. In addition, some lawyers want to help a specific country and will provide pro bono (free) assistance – in many countries lawyers are expected to (or simply wish to) donate a certain amount of pro bono service each year, and often large commercial law firms will provide fragile states with free legal services.

During an initial meeting with a lawyer there should be a discussion about possible conflicts of interest that the lawyer may have. The parties should also have a frank discussion about what information may, or may not, be protected from disclosure by a legal privilege, and the parties should discuss likely costs, if any, of the engagement, and the scope of the engagement. The lawyer should also ask questions about many of the issues discussed above, such as the government's goals and priorities, as well as the main contractual terms discussed below. The government agency, as the client, should also provide the lawyer with all relevant documents.

Contract terms

Contracts are made up of terms: statements of the conditions, requirements, responsibilities and other provisions that each party agrees to undertake. Each term gives rise to a contractual obligation, breach of which can give rise to litigation. A term in the contract may either be expressed or implied. An expressed term is written in the contract document. Implied terms are not written, but nevertheless form a provision of the contract.

It is important that all contract terms be specific and unambiguous. This is particularly important in specifications, definition of targets and unit costs (as applicable), conditions for payment, and grounds for modification of price and other terms. All important terms should be reviewed jointly by the parties to ensure that they attach the same meaning to them. Some contract terms are commonly used and there is broad understanding of their meaning. Terms that should be a part of all contracts for services or goods include:

Parties

The parties to the contract should be specified and properly described. It is important to carefully define who the parties are because it is only the parties to the contract who can formally enforce the contract and have it enforced against them. Thus for government the contracting party should be the body that is accountable for payment and other performance (*i.e.* the ministry or agency that is procuring the services). On the other hand, the government must ensure that the contractor is the proper party to be held accountable and liable. Thus the government should investigate and evaluate the contractor to ensure that the contractor is qualified (or “responsible”). The government should verify that the contractor has sufficient financial backing and management capacity to fulfil the contract and to answer for any breaches. For high-value contracts especially, this verification could include asking for their corporate registration documentation and financial statements, searching for corporate, financial and credit records in private services, and evaluating their financial systems. In some cases, the government agency could feel that there is a risk of the contractor not having sufficient assets (or a risk it will transfer assets) to satisfy its contractual obligations or pay a judgement. In such cases the government can require a guarantee from an owner or third party, or could require a performance bond (see below). For small contracts, the verification could be informal, for example seeking references from other governments, government agencies and donors. The contract should also make contractors responsible for all subcontractors, including monitoring and enforcement to minimise corruption.

Scope of work

The contract must describe what services and/or goods are to be delivered and the applicable quality standards. Often a contract will also describe how and where the goods or services are to be delivered; contracting officials often demand that the risk of damage in transit remain with the contractor until an item is received, inspected and accepted at the destination, typically a government facility. In some

cases the contract could provide for the potential to “scale up”, *e.g.* to allow services to be delivered in other geographic areas. Developing a scope of work is discussed in detail in Chapter 4.

Price

The contract must clearly state the price or compensation for services. Price is closely connected to risk: the higher the risk the higher the return the contractor will demand. Several types of risk are discussed in Box 5.5. A variety of price arrangements are used in contracting out government services. These include: fixed-price, performance-based (*e.g.* unit-price) and labour contracts; and other cost-based contracts. These have already been discussed in Chapter 4 (Section 4.2). Cost-based contracts can require sophisticated (and expensive) cost accounting and auditing systems; they are therefore less common in developing procurement systems. Cost-based contracts can also encourage contractors to produce high-quality services – sometimes too high quality, as the contractor produces the highest quality possible because it will be reimbursed for all efforts. In an incentive or performance-based contract, payment (in full or a significant proportion) is made upon verified delivery of the agreed service (Annex D).

Payment

Payment terms in a contract should outline how often the provider will submit invoices; documentary requirements, including evidence of performance; when payment shall be made; and compensation for late payments. The government may want to reserve the right to inspect and audit the contractor’s work and payment demands. Payment mechanisms for contracting out government services include: (1) payment upon completing the task; (2) monthly or other periodic payments of fixed or variable amounts (the latter depending on outputs, outcomes, etc.); (3) “capitation” payments where the contractor is paid for delivering a set of services for a targeted population; or (4) a delivery-based payment for each person served, such as patients or students. In addition, if payments for services

Box 5.5. Types of risk after a contract has been agreed

- **Payment risk:** the risk associated with government's ability and commitment to pay
- **Demand risk:** the risk associated with consumers' ability and willingness to pay for services
- **Performance risk:** the risk of properly delivering services or operating an asset and meeting performance standards
- **Political risk:** the risk of a change in government that could alter the project
- **Regulatory risk:** the risk of changes or failure to change regulations (e.g. refusal or inability to change fees or tariffs when costs increase)
- **Foreign exchange risk:** the risk of local currency depreciation and devaluation
- **Security risk:** the risk of harm to project staff or assets due to security problems

are being made by third parties (citizens, businesses, etc.) the contract must state how fees will be collected and revenues allocated. Finally, the government may wish to condition payment on the availability of funding; if the funding mechanism is sufficiently transparent (for example, publicised on the Internet), the government may, in effect, be able to shift to the contractor at least some obligation to monitor the availability of funds, *i.e.* the contractor may be at risk if it fails to confirm that funds are available.

Duration

The contract must outline the timeframe over which the work will be provided. That contract duration, or "term," will often coincide with the availability of funds. For example, a base year contract may span one fiscal year, with further options available in succeeding project years. The contract term may be based on fixed dates or a timeline, and may include a base period and optional extension periods; the options may be unilaterally exercised by the government or be triggered by mutual agreement. The ability to extend can be important to avoid service delivery gaps as a result of delays in finalising a

subsequent tender. In fragile states it may often be advisable to develop shorter contracts since many factors will change quickly, including the level of risk (which affects pricing among other things) and the ability of the government to resume or begin providing the services. However, short-term contracts have higher relative costs because start-up costs (including project design, implementation of monitoring and implementation systems) will need to be incurred again when contracts are resumed or extended. Moreover, the price offered by bidders may rise as they seek to "front-load" their pricing to take account of the risk that a contract might not be extended. In addition, longer-term contracts can allow a contractor time to establish relationships and allow for continuity in practice. On the other hand, long-term contracts (*e.g.* over five years) lose the positive impacts of competition.

>TIP: In fragile states it may often be advisable to develop shorter contracts since many factors will change quickly, including the level of risk (which affects pricing among other things) and the ability of the government to resume or begin providing the services directly itself.

Monitoring

The contract should include the following provisions for monitoring and verification (see Chapter 4):

- **Specific performance indicators** to measure whether the contractor is meeting the objectives of the contract. The specification of performance indicators and their measurement is critical to successful contracting as the indicators greatly influence contractor behaviour. These indicators should be quantitative (see **Haiti** example in Box 5.6, and Box 4.3 on involving stakeholders in monitoring health services in **Afghanistan**). The more specific the contract is about its performance expectations and monitoring, the lower the risk to government (Abramson, 2001). The indicators must be clear, measurable and directly relevant to the deliverables (under output-based contracts). The contract should also state who will supervise and monitor the project and how performance achievement will be determined. Supervision and monitoring can be done by the contracting agency or by a third party.⁵ For example, paralegal programmes to expand access to justice are monitored by community boards in **Sierra Leone**, by the Supreme Court in **Nicaragua**, and in northern **Uganda** by courts (when the paralegals are employed by the courts) and the Legal Aid Society of Uganda (OECD, 2009).

5. In the case of performance-based and output-based aid (OBA) contracts (see Annex D), pre-agreed payment for the delivery of specified outputs is conditional upon verification by an independent verification agent (IVA). The IVA is typically a specialised consultant with technical expertise to conduct field visits to verify reported outputs. Independent verification is conducted in accordance with the payment schedule in the contract or agreement for service provision between the contracting authority and the service provider. IVA reports contain the following items: (1) level of progress; (2) a listing of the current updated schedule of types of output and associated pre-agreed unit costs; (3) a certified list of outputs completed and delivered; and (4) certification that the number of verified outputs multiplied by their unit costs reflects the total disbursement request. By paying for verified outputs, OBA internalises the monitoring of results. Best practice would also be to use the OBA monitoring approach to also check other aspects of service delivery.

- **Monitoring mechanisms.** There is a variety of approaches to monitoring. For example, under a World Bank grant, the contract for the Watershed Rehabilitation Project in **Afghanistan** included participatory planning with the farmers in the contract area to develop a resource monitoring system. Contracts should also provide for a protocol for evaluating the results: who will do the evaluation, how often, using what data sources, and how will the results be used? For example, the **Costa Rica** Social Security Fund has a contract with the co-operative COOPESALUD to provide primary health care. This is evaluated by the fund's staff every six months. Evaluation activities include analysis and adaptation of data collection instruments being used by COOPESALUD, analysis of routine data collection results, interviews and focus groups (Abramson, 2001).

- **A list of actions to be taken when the level of service does not match the indicators.** These can include penalties, discussions on why the indicators have not been met, ameliorative actions or waivers of the indicators, mediation and enforcing the contract through lawsuit or arbitration.

>**TIP:** An effective approach to monitoring and verification is for a third party to conduct an assessment under separate contractual arrangements. This can be an effective anti-corruption measure and can help reinforce the impartiality of performance assessment (see Annex D on the independent evaluation of output-based aid).

Termination

The contract should clearly define any reasons for premature termination and the procedures for doing so. Reasons for termination can include the breach of any material term in the contract, non-performance or poor performance (such as failure to meet performance indicators). In extraordinary circumstances the contract can also be terminated for subjective reasons for which no explanation needs be given. The latter (sometimes called a

Box 5.6. Performance indicators in Haiti

In 1999, USAID introduced performance-based contracting to improve the effectiveness of Haiti's NGOs in providing basic health care services. Indicators used to measure performance include the percentage of women using ORT (oral rehydration

therapy) to treat diarrhoea in children; immunisation coverage; coverage rate of three parental visits; and the percentage of clinics with at least four modern methods of family planning.

Source: Abramson, W. (2008), "Scoping Paper: Experience", in OECD (2008), Contracting out of Core Government Functions and Services in Fragile, Post Conflict and Developing Countries, OECD, Paris

government's "termination for convenience") typically requires a defined notice period so that the contractor is not unfairly harmed. A termination for convenience may also trigger other compensation arrangements, such as reimbursing the contractor's sunk costs or, in the worst case, paying the contractor's lost profits. Other procedures relating to termination can include forfeiture of performance bonds, written notice to cure problems, and mediation (negotiating a solution with help from a neutral third-party mediator – see below). The contract should describe what payments will be due to the contractor in the event of early termination.

Force majeure

The contract should contain a clause stating that failure by the government or contractor to fulfil obligations under the contract will not be considered a default (and any delay against a contractual schedule will be excusable) if the failure is the result of a force majeure (outside the control of the parties). The events that constitute a force majeure should be listed in the contract, and often include a war, strike, riot, crime or an "act of God" (*e.g.*, flooding, earthquake, epidemic, volcanic eruption). While other unforeseeable events may qualify as force majeure, by listing the most commonly-recognised the parties will reduce future negotiating costs.

Modification

The contract should clearly state in what way its terms can and cannot be modified. Ideally modification should be made in writing only; oral modifications should be unenforceable so as to reduce corruption and misunderstandings. The modification process, and the authority of officials to make modifications, should be clearly defined in the contract. The contract should also state whether all modifications must be bilateral, or whether the government may unilaterally impose modifications as long as there is proper compensation for the contractor.

Dispute resolution

The contract should describe where and how disputes will be resolved. This is discussed in detail below under the section on "Contract enforcement".

Other terms that should be considered can be found in Box 5.7. Annex B contains a template for contracts for government services. This template only guides users through the issues to be considered when developing a contract – it should not be used as a form. Users of this handbook should consult a lawyer in their country to ensure the enforceability of the contract and all of its terms. Annex A provides sources for form contracts and templates and guidance on contracts.

Box 5.7. Contract terms

Many contracts contain a list of what the terms used in the agreement mean to the parties. This is good practice as it helps to avoid future disputes over the meanings of the terms:

Accounting and information

Contracts should include requirements to maintain accounting and financial records. In many cases, the contractor should maintain information regarding services provided, number of users, quality of services, and inputs. The government can also require that the contractor or the project be audited each year, although this is expensive and the government should consider whether it is appropriate.

Reporting

The contract should include reporting requirements that the contractor must satisfy. They can include periodic (monthly, quarterly, annual) descriptions of progress, performance against indicators, revenues and costs, and financial or bank account statements.

Specification of performance outcomes

Some contracts target improved services to certain populations, for example low income citizens. In addition to specifying the indicators of this performance, the contract can provide incentive payments for performance or disincentives for failing to meet the targets. Consideration should be given to the applicability of incentive payments in the contract, either by structuring payments in such a way that they are contingent on the achievement of certain levels of service, or by offering bonus payments for achievement of service levels above a pre-defined baseline.

Management responsibility

Contracts should describe who is responsible for management decisions. There are some potential advantages to providing contractors with significant managerial autonomy: decisions are made by

those with the greatest understanding of the situation on the ground; it is easier to hold contractors accountable for results when they were responsible for all decisions; it encourages innovations that can lead to improved performance.

Government management of the contract

The government needs to identify who will manage the contract. Depending on capacity and politics, management can be undertaken within a ministry or other state level agency, local governments, special government procurement units, or by an outside contractor. The regulator's role and authority should be spelled out in the contract even if it is already set forth in a law, regulation or decree.

Procurement of supplies and equipment

Where the contract will include procurement of goods, the contract should state whether the government or contractor will conduct the procurement. See Chapter 3 for guidance on which should conduct procurement. As demonstrated in the Southern Sudan example in Case Study 5 (Chapter 2), a contract to provide procurement services should be structured to ensure that the government can quickly take over procurement, but should be based on the realities of the situation in the government.

Warranty

The government can require that the contractor provide a warranty of quality of goods and services provided. The contract should clearly state the contents and the period of warranty.

Ownership of assets purchased with contract funds

Where provision of the service includes acquisition of assets by investment, purchase or other transfer the contract should specify who ends up with ownership of the assets.

Changes in the law

The contract can include a clause that sets forth what happens if the underlying law changes. For example, if the contract provides for supply of trucks with gasoline engines and the law is amended to require that all government vehicles be electric powered, what are the obligations of the contractor? Or if a change in the law increases or decreases costs, should the remuneration and reimbursable expenses be increased or decreased?

Budget

Often a budget for a project will be included as part of the contract. Budgeting is discussed in detail in Chapter 3.

Tax exemptions

The contract might grant certain tax exemptions to the contractor to either encourage bidders, eliminate the steps of the government paying for the taxes due to the government itself, or to encourage foreign personnel, equipment and supplies to be brought into the country.

Conflicts of interest

In some cases the contract should spell out what arrangements and relationships will constitute prohibited conflicts of interest.

Confidentiality

The parties should consider whether any of the information relating to the contract should be confidential and how it should be designated. The parties might also include means to obtain consent to disclose confidential information.

Financing arrangements

These are discussed in the main text.

Capacity building

The contract can make the contractor responsible for developing the capacity of government staff, project staff, or others.

Miscellaneous provisions

There may be various miscellaneous provisions that need to be included in a particular jurisdiction. These include clauses such as on waivers (e.g. a failure to exercise a right does not preclude the future exercise of that right), authorised representatives and assignment (normally assignment of the contract should be precluded). Or they may include a statement that the contract is the entire agreement between the parties (no oral or prior agreements are included in the contract).

Financial arrangements for contracts

This section outlines the financial arrangements that can be used to secure contracted-out projects. These arrangements include secured loans, guarantees, surety bonds, on-lending and advance payments.

Secured loans

Secured loans are normally made by banks and are the most common form of financing in most fragile states. Secured loans are not part of the contract, although the contract might require that the contractor obtain and maintain financing from a third party to ensure it can carry out the project. They are loans in which the borrower pledges one of its assets (*e.g.* equipment or rights to future payments or accounts receivable) as collateral for the loan. If the borrower fails to repay the loan, the creditor takes possession of the asset used as collateral and may sell it to pay off the debt. This reduces the lender's risk of non-payment, which allows borrowers to receive loans on more favourable terms (lower interest rates, longer repayment time, etc.) or under circumstances when unsecured debt would usually rule out lending.

Guarantees

Guarantees are used widely in both developing and developed economies as a way to offset risk. They allow for a third party to guarantee the repayment of the borrower's debt. As with secured loans, a guarantee mitigates lending risk and thereby increases access to finance under more favourable terms. There are various types of guarantees, three of which have particular relevance to contracting out government services:

1) Loan guarantees: guarantees in which a third party agrees to repay a percentage of the debt (often 50 to 100%). A partial guarantee can be used by a government or donor to share the risk in a project. Several donors have established guarantee packages that include loan guarantees and loan portfolio guarantees (to cover loans to a number of borrowers, often in a particular sector).

2) Bond guarantees: these guarantee a bond issuance for a government entity or a structured or project finance transaction. A bond is a debt instrument issued by a government entity or other agency, usually in local currency. Bonds can be structured in a variety of ways governing when and how they will pay out (*e.g.* interest only, principal and interest, discounted to be paid out at maturity, etc.). In general, bond issuances have a higher probability of payback than other investments, but if the issuer is an entity with a poor or no credit rating, it can be difficult to launch a successful bond issuance. A bond guarantee can lower the perceived risk of a bond by assuring investors that they will receive their money. National governments, banks and donors acting on behalf of government entities with insufficient credit ratings can make bond guarantees. However, bond issuances are expensive and should only be used for large projects.

3) Donor guarantee funds include the World Bank Multilateral Investment Guarantee Agency (MIGA) and USAID Development Credit Authority (DCA). MIGA provides political risk insurance for foreign investors, including contractors. DCA provides partial credit guarantees that cover up to 50% of defaults on loans made by private financial institutions.

Surety bond

A surety bond is a three-party agreement whereby the surety (a person or company) guarantees to the government that the contractor will perform the contract in accordance with the contract documents. There are several different types of contract surety bonds:

- A **bid bond** provides financial assurance to the government that the bid has been submitted in good faith, and that the contractor intends to enter into the contract at the bid price and ultimately provide the required performance and payment bonds.

- A **performance bond** (or sometimes a performance guarantee) protects the government from non-performance and financial exposure should the contractor default on the contract. It is directly tied to the underlying contract and if the contractor is unable to perform the contract, the surety has responsibilities to the owner and contractor for project completion. In **Liberia** (Case Study 12, below), performance bonds have been used to control corruption and conflict. Sometimes they are used to protect the country from environmental damage, as in **Indonesia**, where the government requires mine operators to post a reclamation guarantee reflecting the value of the potential environmental damage the mining operation could cause. The amount of the guarantee is set at the estimated cost of repairing the damage caused. The Indonesian government refunds the guarantee upon satisfactory performance by the operator (US EPA, 2004).
- A **payment bond**, sometimes called a labour and material bond, protects certain subcontractors, labourers and material suppliers against non-payment by the contractor. Generally, these claimants may seek recovery directly from the surety company under the payment bond. It also protects the government from these subcontractors asserting their right to sue the project for non-payment.
- A **maintenance bond** guarantees against defective workmanship or materials for a specified period.

Case Study 12. New forest operations in Liberia

When the war ended in 2003, the UN Security Council began to work with the Government of Liberia on forest sector reforms that would ensure that logging would no longer fuel conflict. The Security Council insisted on these reforms before timber sanctions could be lifted. The Government of Liberia, assisted by the international community – especially the US Forest Service and the World Bank – examined all 70 companies that claimed to have concessions to log in Liberia. They found that for the last 20 years, previous administrations had granted overlapping concession areas and used contracts as a form of patronage to reward cronies. Further, it was discovered that not one single company actually had the legal right to log. In 2006, the first Executive Order of the new government established that all of these alleged contracts were null and void, and therefore they would not stand in the way of allocating new, legal contracts.

In June 2006, the Security Council acknowledged the new government reforms, which lifted the sanctions on timber. New logging contracts were awarded in 2008. A requirement included in the new logging contracts was that the operator must then post a performance bond worth a minimum of USD 25 000 (for timber sales contracts), USD 150 000 (for small forest management contracts), USD 250 000 (for large FMCs), or half of the expected government revenue (excluding land rent) for the first year, or a maximum of USD 1 million.

Lessons learned: A performance bond requirement can protect the government from the risk of non-performance by a contractor and can help reduce patronage and corruption.

On-lending

On-lending is a way to provide capital through a government ministry or directly to commercial financial institutions, which is then lent on to targeted beneficiaries. It makes capital available to support private sector investments in providing government services and can help overcome financial system weaknesses such as the lack of liquidity, short debt maturity or high risks. A fund provider grants or lends money to a second-tier government or private organisation known as an Apex, which then makes funds available to commercial financial institutions for on-lending to targeted beneficiaries. This approach is often used by donors to reach borrowers with limited access to the financial system. It could be used to support smaller contracts with domestic contractors in fragile states.

Advance payments

Advance payments are a type of contract financing that a government can provide to contractors to accomplish or to maintain progress on essential programme or contract objectives. However, it is unlikely that a fragile state would use them often, since the government is likely to lack financing – one reason for contracting out is to finance aspects of government services. Moreover, advance payments eliminate one of the government's few points of leverage – payment – for ensuring good performance. However, where the government has sufficient financial capacity, advance payments can be used when it would otherwise be difficult for the contractor to obtain the necessary financing.

5.4. Contract enforcement

Contract enforcement measures are needed to deal with a breach of contract terms (a failure to perform obligations required under the contract). They outline the procedures that must be followed to obtain monetary damages or other redress for the breach. However, to try to maintain their relationship and minimise the costs of contract enforcement, the parties should first try to negotiate a resolution to the breach of contract. This resolution could include rectifying the poor performance and continuing the work, or paying back an agreed amount. If negotiation is not successful, the government may wish to launch informal mediation mechanisms through local or international mediators.

In any case, the contract should include provisions for preventing and dealing with contractor non-performance and for dispute resolution. There are several issues that should be considered when the contract is drafted:

- **Structure the contract to ease enforcement.**
The more specific the contract terms, the easier it

will be to enforce them. For example, if the contract states that “the contractor shall commence delivery of sanitation services to the city of x as soon as possible” it may be difficult to determine if after one year the contractor's failure to deliver is a breach of contract. But if the contract states that “the contractor shall commence delivery of sanitation services to the city within six months of the date of the contract”, it is clear that failure to deliver within six months is a breach of contract.

- **Continuing the services during a dispute.**
The contract can state that even in the event of a dispute, including instigation of a lawsuit or arbitration, the services shall continue to be provided by the contractor, or can be obtained from other sources. This is especially important for basic services that are crucial to health, safety and livelihoods. As a practical matter, however, and depending upon the implementing state's legal regime, if the government makes a truly material change to the contract scope without the

contractor's consent it may not be able to force a contractor to continue providing services. If the government insists that contractors can be forced to continue services during a dispute, only politically-connected contractors would bid or agree to such a contract. A contractual provision like this should, therefore, only be used if the government has appropriate management resources in place, including the means for addressing disputes between the parties in a rapid and efficient manner.

- **Defining damages and other remedies.** A contract can set out the damages or compensation to be paid by a contractor for breach of contract. Liquidated damages are specified amounts spelled out in a contract, payable for specific failures in performance, such as a missed day of work. They allow the parties to collect monetary compensation without having to prove the exact amount of damage. They are often used by governments in construction contracts to ensure timely performance by the contractor.
- **Mediation provisions.** A mediation clause in the contract can require parties to mediate (negotiate a solution with help from a neutral third party mediator) before filing a lawsuit in court or commencing arbitration. It should be noted that in many countries there are strong traditional mechanisms for dispute resolution that may be preferable to courts or arbitration. These mechanisms could be included in the contract. Annex A sets out a number of dispute resolution providers and sources of guidance.
- **Location of dispute resolution.** If the parties believe that dispute resolution can be efficiently conducted in the state courts, a clause in the contract should state this and should specify which court within the country will consider contract disputes.

>**TIP:** Governments that invest in honest and efficient dispute systems, whether informal to formal, will ensure that disputes – which are an inevitable

part of an inherently imperfect procurement process – can be resolved promptly and fairly. The alternative to a fair and efficient disputes process is for contractors to seek a political solution, which encourages corruption and political interference in the procurement process.

Dispute resolution

- It is very important to determine where and how disputes over the contract will be resolved and breaches of contract enforced. The parties should attempt to directly resolve any disputes through negotiation before they use courts, arbitration or even mediation.
- In most countries, if a dispute cannot be resolved through negotiation between the parties, most are resolved in the country's courts. In many fragile states, however, one or more parties may be concerned that the state courts lack adequate capacity, are too slow or backlogged, or may be biased in favour of either the government or contractor. In such cases, the alternatives are: **domestic arbitration** (if the contractor is a domestic entity); **international arbitration** (through an international arbitration provider); or the **courts in the contractor's home country or a third country** (though establishing that a third-country court has jurisdiction may be difficult).
- For international tenders or where the contract value is large, international arbitration is probably the most desirable venue for dispute resolution. There are several established international arbitration providers, including the International Chamber of Commerce International Court of Arbitration (ICC ICA). This is based in Paris but hears disputes throughout the world. There are also international courts of arbitration in over 80 countries that are affiliated to the ICC ICA and which hear disputes involving foreign companies. For international commercial arbitration to work, arbitration awards must be enforceable across borders. Thus, in 1958, the United Nations estab-

lished the New York Convention, which obliges each signatory country to enforce foreign awards. Over 140 countries have signed the convention and many countries have also enacted legislation to support international commercial arbitration based on the UNCITRAL Model Law on International Commercial Arbitration (Box 5.1).

Legal enforcement

If one of the parties breaches a term of the contract and the contract provides for enforcement in a domestic or foreign court, the legal enforcement options are typically to:

1) Obtain a judgement or other instrument that can be executed, such as an arbitration award. In most cases a court or an arbitrator will need to adjudicate the case before a judgement can be issued.

- Obtaining a court *judgement* normally involves first filing a notice of lawsuit and complaint stating the reasons and damages requested. A trial follows, in which evidence is submitted and the court (or in some countries a jury) determines the facts, whether the complaint is valid and the amount of the damages. The resulting document is called a judgement, and can be enforced as described below. The rules for procedures in court cases are set out in the civil procedure law, normative acts and court rules.
- The process for obtaining an *arbitration* award is similar but less formal and usually faster. A statement of claims is filed that briefly states reasons for the case and the damages requested, and an arbitration hearing is held during which evidence is submitted and the arbitrator determines the facts, whether the claim is valid and the amount of damages to be paid. The resulting document is an arbitration award, and can be enforced as described below. The rules for procedures in arbitration cases are set out in the contract or the rules of the arbitration service, or both, with some procedures spelled out in a law on arbitration in some countries.

2) Enforce the judgement, arbitration award or other enforceable instrument by seizing and selling assets. An enforcement system should include several key procedures:

- A levy on all kinds of property and the ability to collect funds from any asset owned by the judgement debtor (the entity that owes money).
- Procedures for discovering the assets of a judgement debtor, such as an examination under oath, ability to search records of assets, etc.
- Expedited procedures to seize certain easy-to-seize assets, like money held in a bank account.
- Expedited procedures for secured creditors to foreclose on their collateral.
- Provisional remedies – procedures that can be used at the outset of a lawsuit to seize assets and make sure that a judgement won't be uncollectible by the time of enforcement.
- Efficient procedures for the sale of assets so they can be sold quickly and for a maximum price.
- Oversight and supervision of enforcement officers or agents (the people who seize assets on behalf of the judgement creditor, *i.e.* the entity that is owed money).
- Penalties for non-compliance with orders to turn over assets so that judgement debtors and third parties will not transfer or hide assets or interfere with enforcement officers' work.

>TIP: A good system for enforcing judgements will provide creditors with a fast and efficient way to collect debts while protecting debtors' rights. A bad enforcement system will be slow, corrupt and/or will not protect debtors' rights. The World Bank Doing Business Project ranks enforcement systems and provides a list of the steps for enforcing contracts – including obtain-

ing a judgement and enforcing the judgement – in 183 countries (see www.doingbusiness.org).

Either before or during enforcement proceedings, the parties should attempt to **settle** the dispute. This involves negotiation, similar to the negotiation

that established the contract (see above for guidance on negotiating). If the contract negotiation was conducted without acrimony and using techniques to maximise benefits to both parties, a settlement negotiation will be more likely to succeed.

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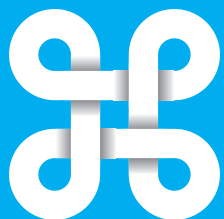
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Useful resources

Please see the complete list of legal resources in Annex A.



Annexes

Annex A

Resources for further information

Trade agreements and regional structures for procurement

The following trade agreements and regional structures include agreements and arrangements for participation in government procurements and procurement procedures.

Name	Acronym	Website
Asia Pacific Trade Agreement	APTA	www.unescap.org/tid/apta.asp
Association of the Southeast Asian Nations	ASEAN	www.aseansec.org
Building Partnerships for Development	BPD	www.bpdws.org
Central American Free Trade Agreement	CAFTA	www.caftaintelligencecenter.com
Andean Community	CAN	www.comunidadandina.org/endex.htm
Caribbean Community	CARICOM	www.caricom.org
Central European Free Trade Agreement	CEFTA	www.cefta2006.com/en-index.php
The Common Market for Eastern and Southern Africa	COMESA	www.comesa.int
East African Community	EAC	www.eac.int
Economic Community of Central African States	ECCAS	www.africa-union.org/root/au/recs/eccas.htm
Economic Community of West Africa States	ECOWAS	www.ecowas.int
European Free Trade Association	EFTA	www.efta.int
European Union	EU	www.europa.eu
Greater Arab Free Trade	GAFTA	www.mit.gov.jo/Default.aspx?tabid=732
Latin American Free Trade Association	LAFTA	www.aladi.org
Southern Common Market	SADC MERCOSUR	www.mercosur.int

North American Free Trade Agreement	NAFTA	www.nafta-sec-alena.org
Pacific Island Trade Agreements	PICTA	www.forumsec.org
South Asian Association for Regional Cooperation South Asia Free Trade Agreement	SAARC & SAFTA	www.saarc-sec.org
Southern African Development Community	SADC	www.sadc.int
World Trade Organization	WTO	www.wto.org

There are also many bilateral agreements between countries that provide for non-discriminatory treatment for government procurements and contain rules relating to procurements.

Finding lawyers and other professional assistance

Sources of information on lawyers and other professionals who can help to structure and draft a contract for government services include national and international bar associations, introductions from governments in other countries that have contracted out government services, and referrals from lawyers and other professionals. Some international sources include:

- International Bar Association Members
www.ibanet.org/barassociations/bar_associations_home.aspx
- International Centre for Commercial Law
www.legal500.com
- Martindale-Hubbell
www.martindale.com
- MSI Global Alliance
www.msiglobal.org
- Who's Who Legal
www.whoswholegal.com

Sources for form contracts/templates and guidance on contracts

- International Federation of Consulting Engineers (FIDIC)
www1.fidic.org/resources/contracts/default.asp?back=/resources/default.asp
- Master Procurement Documents - Prequalification Documents for Procurement of Works and User's Guide
<http://old.developmentgateway.org/download/255677/MasterPQ-06-16-03.pdf>
- Multilateral Development Banks e-Government Procurement Portal, e-GP Toolkit
www.mdbegp.org/www/eGPToolitus/tabid/67/language/en-US/Default.aspx
- UNCITRAL Model Law on Procurement of Goods, Construction and Services, with Guide to Enactment
www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure/1994Model.html
- World Bank Sample Bidding Documents for Output- and Performance-Based Road Contracts
<http://go.worldbank.org/NMR4NH2CU0>

Dispute resolution providers and sources for guidance

- ADR Chambers International
www.adrchambersinternational.com
- American Arbitration Association, International Centre for Dispute Resolution
www.adr.org/sp.asp?id=28819
- Association for International Arbitration
www.arbitration-adr.org
- Centre for Effective Dispute Resolution
www.cedr.co.uk
- International Chamber of Commerce International Court of Arbitration
www.iccwbo.org/court/arbitration
- International Institute for Conflict Prevention and Resolution
www.cpradr.org
- London Court of International Arbitration
www.lcia-arbitration.com

- Mediate.com
www.mediate.com
- Permanent Court of Arbitration
www.pca-cpa.org

Annex B

Template for contracts for government services¹

A. General

- 1.1** Budget means the priced and completed Budget forming part of the Contractor's Bid.
- 1.2** The Completion Date is the date of completion of the Works as certified by the Project Manager, in accordance with Sub-Clause 55.1.
- 1.3** The Contractor is [insert name of entity] whose Bid to carry out the Works has been accepted by the Government.
- 1.4** The Contractor's Bid is the completed bidding document submitted by the Contractor to the Government.
- 1.5** The Contract Price is the price stated in the Letter of Acceptance and thereafter as adjusted in accordance with the provisions of the Contract.
- 1.6** A Defect is any part of the Works not completed in accordance with the Contract.
- 1.7** The Defects Liability Period is a period of xx months, calculated from the Completion Date.
- 1.8** The Government is the party who employs the Contractor to carry out the Works.
- 1.9** The Initial Contract Price is the Contract Price listed in the Government's Letter of Acceptance.
- 1.10** The Intended Completion Date is the date on which it is intended that the Contractor shall complete the Works. The Intended Completion Date is [insert date]. The Intended Completion Date may be revised only by the Project Manager by issuing an extension of time or an acceleration order.
- 1.11** The Project Manager is [insert name] (or any other competent person appointed by the Government and notified to the Contractor, to act in replacement of the Project Manager) who is responsible for supervising the execution of the Works and administering the Contract.
- 1.12** The Site is [describe site if applicable].
- 1.13** Specification means the Specification of the Works included in the Contract and any modification or addition made or approved by the Project Manager.

1. Adapted from World Bank, Standard Conditions of Contract (<http://go.worldbank.org/RJ3F7LCI00>).

	<p>1.14 The Start Date is [insert date]. It is the latest date when the Contractor shall commence execution of the Works. It does not necessarily coincide with any of the Site Possession Dates.</p> <p>1.15 A Subcontractor is a person or corporate body who has a Contract with the Contractor to carry out a part of the work in the Contract, which includes work on the Site.</p> <p>1.16 The Works are what the Contract requires the Contractor to construct, install, and turn over to the Government, defined as [insert description].</p>
	<p>2.1 The language of the Contract shall be English and the laws of the country of _____ shall govern the Contract.</p>
	<p>3.1 Except where otherwise specifically stated, the Project Manager will decide contractual matters between the Government and the Contractor in the role representing the Government.</p>
	<p>4.1 The Project Manager may delegate any of his duties and responsibilities to other people, after notifying the Contractor, and may cancel any delegation after notifying the Contractor.</p>
	<p>5.1 Communications between parties that are referred to in the Conditions shall be effective only when in writing. A notice shall be effective only when it is delivered.</p>
	<p>6.1 The Contractor may subcontract with the approval of the Government, but may not assign the Contract. Subcontracting shall not alter the Contractor's obligations.</p>
	<p>7.1 The Contractor shall cooperate and share the Site with other contractors, public authorities, utilities, and the Government as stated in this Contract or any other writing from the Government.</p>
	<p>8.1 The Contractor shall employ the key personnel named in the Schedule of Key Personnel, as referred to in the Contract Data, to carry out the functions stated in the Schedule or other personnel approved by the Project Manager. The Project Manager will approve any proposed replacement of key personnel only if their relevant qualifications and abilities are substantially equal to or better than those of the personnel listed in the Schedule.</p> <p>8.2 If the Project Manager asks the Contractor to remove a person who is a member of the Contractor's staff or work force, stating the reasons, the Contractor shall ensure that the person leaves the Site within seven days and has no further connection with the work in the Contract.</p>
	<p>9.1 The Government carries the risks which this Contract states are Government's risks, and the Contractor carries the risks which this Contract states are Contractor's risks.</p>

	<p>10.1 From the Start Date until the Defects Correction Certificate has been issued, the following are Government's risks:</p> <p>a. The risk of [personal injury, death, or loss of or damage to property (excluding the Works, Plant, Materials, and Equipment)], which are due to negligence, breach of statutory duty, or interference with any legal right by the Government or by any person employed by or contracted to him except the Contractor.</p>
	<p>11.1 From the Starting Date until the Defects Correction Certificate has been issued, the risks of personal injury, death, and loss of or damage to property (including, without limitation, the Works, Plant, Materials, and Equipment) which are not Government's risks are Contractor's risks.</p>
	<p>12.1 The Contractor shall provide, in the joint names of the Government and the Contractor, insurance cover from the Start Date to the end of the Defects Liability Period, in the amounts of [insert amount] for the following events:</p> <p>a. loss of or damage to the Works, Plant, and Materials;</p> <p>b. loss of or damage to Equipment;</p> <p>c. loss of or damage to property (except the Works, Plant, Materials, and Equipment) in connection with the Contract; and</p> <p>d. personal injury or death.</p> <p>12.2 Alterations to the terms of an insurance shall not be made without the approval of the Project Manager.</p>
	<p>13.1 The Contractor may commence execution of the Works on the Start Date and shall carry out the Works in accordance with the Work Plan submitted by the Contractor, as updated with the approval of the Project Manager, and complete them by the Intended Completion Date.</p>
	<p>14.1 The Contractor shall be responsible for the safety of all activities on the Site.</p>
	<p>15.1 The Government shall give possession of all parts of the Site to the Contractor. If possession of a part is not given by the date stated in the Contract Data, the Government will be deemed to have delayed the start of the relevant activities, and this will be a Compensation Event.</p>
	<p>16.1 The Contractor shall allow the Project Manager and any person authorized by the Project Manager access to the Site and to any place where work in connection with the Contract is being carried out or is intended to be carried out.</p>

	<p>17.1 The Contractor shall carry out all instructions of the Project Manager which comply with the applicable laws where the Site is located.</p> <p>17.2 The Contractor shall permit the Bank to inspect the Contractor's accounts and records relating to the performance of the Contractor and to have them audited by auditors appointed by the Bank, if so required by the Bank.</p>
	<p>18.1 In the event of a dispute between the parties relating to this contract, either party may refer a decision of the Adjudicator to an Arbitrator within 28 days of written notice of a dispute.</p> <p>18.2 All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.</p>
B. Time Control	
	<p>19.1 Within the time stated in the Contract Data, the Contractor shall submit to the Project Manager for approval a Work Plan showing the general methods, arrangements, order, and timing for all the activities in the Works.</p> <p>19.2 An update of the Work Plan shall be a Work Plan showing the actual progress achieved on each activity and the effect of the progress achieved on the timing of the remaining work, including any changes to the sequence of the activities.</p>
	<p>19.3 The Contractor shall submit to the Project Manager for approval an updated Work Plan at the end of each quarter. If the Contractor does not submit an updated Work Plan within this period, the Project Manager may withhold the amount stated in the Contract Data from the next payment certificate and continue to withhold this amount until the next payment after the date on which the overdue Work Plan has been submitted.</p>
	<p>20.1 The Project Manager shall extend the Intended Completion Date if a Compensation Event occurs or a Variation is issued which makes it impossible for Completion to be achieved by the Intended Completion Date without the Contractor taking steps to accelerate the remaining work, which would cause the Contractor to incur additional cost.</p>
	<p>21.1 The Contractor shall warn the Project Manager at the earliest opportunity of specific likely future events or circumstances that may adversely affect the quality of the work, increase the Contract Price or delay the execution of the Works. The Project Manager may require the Contractor to provide an estimate of the expected effect of the future event or circumstance on the Contract Price and Completion Date. The estimate shall be provided by the Contractor as soon as reasonably possible.</p>

C. Quality Control	
	<p>22.1 The Project Manager shall check the Contractor's work and notify the Contractor of any Defects that are found. Such checking shall not affect the Contractor's responsibilities. The Project Manager may instruct the Contractor to search for a Defect and to uncover and test any work that the Project Manager considers may have a Defect.</p>
	<p>23.1 The Project Manager shall give notice to the Contractor of any Defects before the end of the Defects Liability Period, which begins at Completion, and is defined in the Contract Data. The Defects Liability Period shall be extended for as long as Defects remain to be corrected.</p> <p>23.2 Every time notice of a Defect is given, the Contractor shall correct the notified Defect within the length of time specified by the Project Manager's notice.</p>
	<p>24.1 If the Contractor has not corrected a Defect within the time specified in the Project Manager's notice, the Project Manager will assess the cost of having the Defect corrected, and the Contractor will pay this amount.</p>
D. Cost Control	
	<p>25.1 If the final quantity of the work done differs from the quantity in the Budget for the particular item, the Project Manager shall adjust the rate to allow for the change.</p>
	<p>26.1 When the Work Plan is updated, the Contractor shall provide the Project Manager with an updated cash flow forecast. The cash flow forecast shall include different currencies, as defined in the Contract, converted as necessary.</p>
	<p>27.1 The Contractor shall submit to the Project Manager monthly statements of the estimated value of the work executed less the cumulative amount certified previously.</p> <p>27.2 The Project Manager shall check the Contractor's monthly statement and certify the amount to be paid to the Contractor.</p>
	<p>28.1 Payments shall be adjusted for deductions for advance payments and retention. The Government shall pay the Contractor the amounts certified by the Project Manager within 28 days of the date of each certificate. If the Government makes a late payment, the Contractor shall be paid interest on the late payment in the next payment. Interest shall be calculated from the date by which the payment should have been made up to the date when the late payment is made at the prevailing rate of interest for commercial borrowing for each of the currencies in which payments are made.</p> <p>28.2 Unless otherwise stated, all payments and deductions will be paid or charged in the proportions of currencies comprising the Contract Price.</p>

	<p>29.1 Prices shall be adjusted for fluctuations in the cost of inputs only if provided for in the Budget. If so provided, the amounts certified in each payment certificate, after deducting for Advance Payment, shall be adjusted by applying the respective price adjustment factor to the payment amounts due in each currency.</p>
	<p>30.1 The Government shall retain from each payment due to the Contractor the proportion stated in the Contract Data until Completion of the whole of the Works.</p> <p>30.2 On completion of the whole of the Works, half the total amount retained shall be repaid to the Contractor and half when the Defects Liability Period has passed and the Project Manager has certified that all Defects notified by the Project Manager to the Contractor before the end of this period have been corrected.</p>
	<p>31.1 The Contractor shall pay liquidated damages to the Government at the rate of [insert amount] per day stated in the Contract Data for each day that the Completion Date is later than the Intended Completion Date. The total amount of liquidated damages shall not exceed the amount defined in the Contract Data. The Government may deduct liquidated damages from payments due to the Contractor. Payment of liquidated damages shall not affect the Contractor's liabilities.</p>
	<p>32.1 The Contractor shall be paid a Bonus calculated at the rate per calendar day stated in the Contract Data for each day (less any days for which the Contractor is paid for acceleration) that the Completion is earlier than the Intended Completion Date. The Project Manager shall certify that the Works are complete, although they may not be due to be complete.</p>
	<p>33.1 The Government shall make advance payment to the Contractor of the amounts stated in the Contract Data by the date stated in the Contract Data, against provision by the Contractor of an Unconditional Bank Guarantee in a form and by a bank acceptable to the Government in amounts and currencies equal to the advance payment. The Guarantee shall remain effective until the advance payment has been repaid, but the amount of the Guarantee shall be progressively reduced by the amounts repaid by the Contractor. Interest will not be charged on the advance payment.</p> <p>33.2 The Contractor is to use the advance payment only to pay for Equipment, Materials, Staff and mobilization expenses required specifically for execution of the Contract. The Contractor shall demonstrate that advance payment has been used in this way by supplying copies of invoices or other documents to the Project Manager.</p> <p>33.3 The advance payment shall be repaid by deducting proportionate amounts from payments otherwise due to the Contractor.</p>

	<p>34.1 The Performance Security shall be provided to the Government no later than the date specified in the Letter of Acceptance and shall be issued in an amount and form and by a bank or surety acceptable to the Government, and denominated in the types and proportions of the currencies in which the Contract Price is payable. The Performance Security shall be valid until a date 28 days from the date of issue of the Certificate of Completion in the case of a Bank Guarantee, and until one year from the date of issue of the Completion Certificate in the case of a Performance Bond.</p>
E. Finishing the Contract	
35. Completion	<p>35.1 The Contractor shall request the Project Manager to issue a certificate of Completion of the Works, and the Project Manager will do so upon deciding that the work is completed.</p>
36. Taking Over	<p>36.1 The Government shall take over the Site and the Works within seven days of the Project Manager's issuing a certificate of Completion.</p>
37. Final Account	<p>37.1 The Contractor shall supply the Project Manager with a detailed account of the total amount that the Contractor considers payable under the Contract before the end of the Defects Liability Period. The Project Manager shall issue a Defects Liability Certificate and certify any final payment that is due to the Contractor within 56 days of receiving the Contractor's account if it is correct and complete. If it is not, the Project Manager shall issue within 56 days a schedule that states the scope of the corrections or additions that are necessary. If the Final Account is still unsatisfactory after it has been resubmitted, the Project Manager shall decide on the amount payable to the Contractor and issue a payment certificate.</p>
38. Termination	<p>38.1 The Government or the Contractor may terminate the Contract if the other party causes a fundamental breach of the Contract.</p> <p>38.2 Fundamental breaches of Contract shall include, but shall not be limited to, the following:</p> <ul style="list-style-type: none"> a. the Contractor stops work for 28 days when no stoppage of work is shown on the current Work Plan and the stoppage has not been authorized by the Project Manager; b. the Project Manager instructs the Contractor to delay the progress of the Works, and the instruction is not withdrawn within 28 days; c. the Contractor is made bankrupt or goes into liquidation other than for a restructuring or reorganization; d. a payment certified by the Project Manager is not paid by the Government to the Contractor within 84 days of the date of the Project Manager's certificate;

	<p>e. the Project Manager gives Notice that failure to correct a particular Defect is a fundamental breach of Contract and the Contractor fails to correct it within a reasonable period of time determined by the Project Manager;</p> <p>f. the Contractor does not maintain a Security, which is required; (h) if the Contractor, in the judgement of the Government has engaged in corrupt or fraudulent practices in competing for or in executing the Contract.</p> <p>38.3 Notwithstanding the above, the Government may terminate the Contract for convenience.</p> <p>38.4 If the Contract is terminated, the Contractor shall stop work immediately, make the Site safe and secure, and leave the Site as soon as reasonably possible.</p>
	<p>39.1 If the Contract is terminated because of a fundamental breach of Contract by the Contractor, the Project Manager shall issue a certificate for the value of the work done and Materials ordered less advance payments received up to the date of the issue of the certificate and less the percentage to apply to the value of the work not completed, as indicated in the Contract Data. Additional Liquidated Damages shall not apply. If the total amount due to the Government exceeds any payment due to the Contractor, the difference shall be a debt payable to the Government.</p> <p>39.2 If the Contract is terminated for the Government's convenience or because of a fundamental breach of Contract by the Government, the Project Manager shall issue a certificate for the value of the work done, Materials ordered, the reasonable cost of removal of Equipment, repatriation of the Contractor's personnel employed solely on the Works, and the Contractor's costs of protecting and securing the Works, and less advance payments received up to the date of the certificate.</p>
	<p>40.1 All Materials on the Site, Plant, Equipment, Temporary Works, and Works shall be deemed to be the property of the Government if the Contract is terminated because of the Contractor's default.</p>
	<p>41.1 If the Contract is frustrated by the outbreak of war or by any other event entirely outside the control of either the Government or the Contractor, the Project Manager shall certify that the Contract has been frustrated. The Contractor shall make the Site safe and stop work as quickly as possible after receiving this certificate.</p>

Annex C

Types of contract and their degree of formality

Type of agreement between public and private parties	Type of activity	Examples	Formality/informality of contract	
			Limits of applicability of classical contract	Degree of informality and reliance on relationships
Spot contract (one-off)	Contract ends on completion of order	Building; supply of goods (<i>e.g.</i> drugs); training	Normally formal contract, but informal elements may appear where there is institutional incapacity; difficulty of specifying and measuring qualitative services	<u>Low</u> but repeat contracting may lead to development of trust and flexibility.
Service contract (< 3 years)	Sustained service inputs	Billing, payroll, IT, cleaning	Normally formal contract, but informal elements may appear where there is institutional incapacity; difficulty of specifying and measuring qualitative services; increased difficulty of specifying terms over longer period.	<u>Medium</u> : Some terms may be informal due to growing need to re-define contract terms in light of changing conditions.
Management contract (3-5 years)	Management tasks over a short period	Road maintenance; primary health centre management		
Lease or Concession Contract (10-30 years)	Long-term management and operational finance	Management of hospitals and urban water supply	Normally formal contract, but informal elements may appear where there is institutional incapacity; difficulty of specifying and measuring qualitative services; increased difficulty of specifying terms over longer period.	<u>High</u> : Some terms of the contract are likely to be informal where parties have trust based on a long term relationship, agreed mechanisms for dealing with changed conditions, and contract may be periodically amended.

Annex D

Output-based aid and contracting out

What is output-based aid?

Output-based aid (OBA) is increasingly being used as an innovative mechanism to deliver basic infrastructure and social services to the poor.² It involves a third party (typically a private enterprise, but it can also be a public utility, NGO, community-based organisation, or a separate branch or institution of government) providing services with public funding. The service provider receives payment based on achieving certain outputs or results, such as the number of people vaccinated, internet cafes in schools, working solar home systems installed in villages, functioning household connections to the

electricity network or yard taps as part of a water supply programme. These outputs are typically verified by an independent agent.

The ultimate aim is to increase the effectiveness of scarce public resources. Accountability and governance are enhanced as public funding is linked to the delivery of pre-identified outputs, and therefore waste or inappropriate allocation is minimised.

This annex explains how OBA works and also explores its value as an approach in fragile states. It builds on the experience of the World Bank and the Global Partnership on Output-Based Aid (GPOBA) in implementing OBA (Box D.1). The lessons learned are drawn specifically from the 197 World Bank and non-World Bank OBA projects reviewed in the recent book *Output-Based Aid: Lessons Learned and Best Practices* (Mumssen *et al.*, 2010).

2. OBA is one key element of a broader family of results-based solutions that link incentives to performance. Results-based financing (RBF) instruments are now recognised as one important element in aid delivery. RBF is an umbrella term that includes output-based aid, performance-based payment (performance-based financing (PBF) or pay-for-performance (P4P)), performance-based inter-fiscal transfers, and conditional cash transfers.

Box D.1. A short history of OBA

OBA was formally introduced in the World Bank Group (WBG) in January 2003 when the Global Partnership on Output-Based Aid (GPOBA) was launched as a World Bank-administered donor-funded pilot programme. The aim of the GPOBA was to test OBA with a view to mainstreaming it within the World Bank Group as well as within other development organisations. Over the past five years, the number of OBA projects in the WBG has increased nearly four-fold, reaching more than 130 OBA projects today. These OBA projects are expected to reach about 61 million beneficiaries. Projects using OBA piloted in the

1990s in the information and communications technology sector (Chile) and the roads sector (Argentina) have been replicated and mainstreamed worldwide as one of the key approaches for interventions in these two sectors. In the health and off-grid energy sectors, OBA is recognised as a key financing mechanism to expand targeted access to the poor and is being widely used. In the water, education, and grid-based energy sectors, OBA is still in the pilot stages. Lessons learned from the OBA pilots are now being incorporated in the design of other results-based financing mechanisms.

How does OBA work?

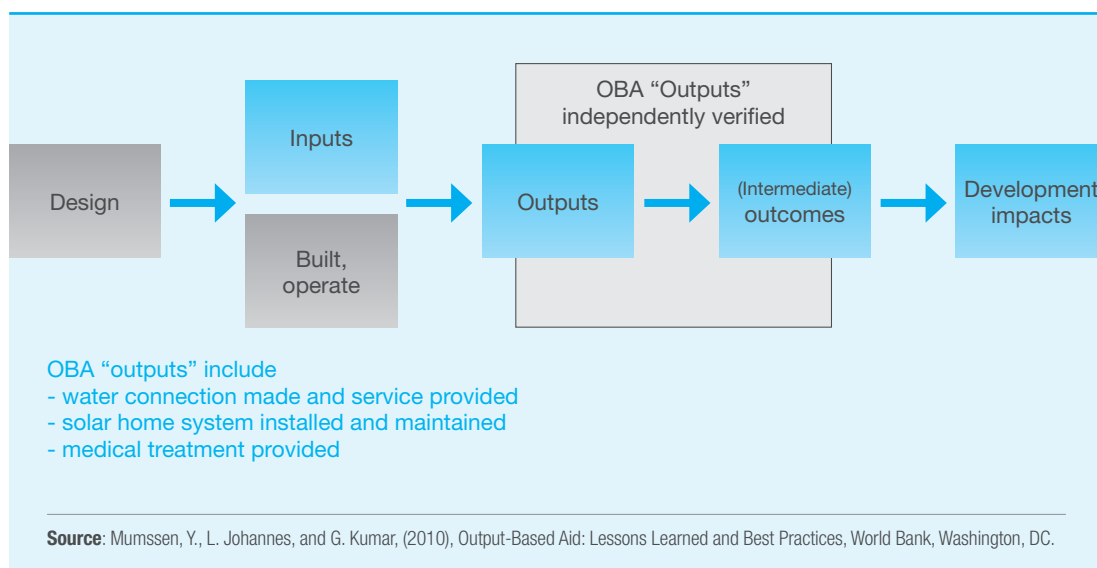
Under traditional procurement, private infrastructure services are contracted at the “input” end of the contracting spectrum (Figure D.1), with the government itself purchasing specific “inputs” (*e.g.* the construction of water treatment plants) and using these to build assets and provide services. “Outputs” in OBA schemes are generally more specific than benchmarks in traditional performance arrangements.

Contracting “closer to the input end” does not guarantee that the inputs the government purchases (*e.g.* building a water treatment plant) will lead to the outcomes (*e.g.* a reduction in waterborne diseases) or impacts (*e.g.* decreased morbidity) that the government actually wants. The idea of “output-based aid” is therefore to contract a third party to deliver an output that is as close as possible to the desired development outcome or impact, while performance risk is still largely under the service provider’s control. Thus, OBA enhances the efficiency of contracting out by linking payment to contractors

with clearly specified outputs, including the targeting of specific groups who lack access to basic services and infrastructure.

The contract (or other official arrangement) is the mechanism through which the output-based payment criteria are established. Given that the emphasis is on service delivery rather than on physical connections, in most infrastructure projects a portion of the payment may only be released after a certain number of months of satisfactory supply, *e.g.* a specified period of electricity service delivery. Hence there is a mixture of “outputs” and “intermediate outcomes” against which payment is made. This ensures sustainability and that service providers to take on appropriate demand risk. However, the further one goes along the output/outcome/impact spectrum, the greater the risk borne by the service provider. Consideration must be given to whether the provider is reasonably able to bear that risk, and at what cost.

Figure D.1. Contracting spectrum



Box D.2. Subsidies and subsidy design mechanisms

Subsidies are defined as public funding used to fill the gap between the total cost of providing a service to a user and the user fees charged for that service. The subsidies complement or replace the user fees. They are justified by the need to improve basic living conditions or the existence of positive externalities when user fees are not feasible.

Subsidies have long existed in infrastructure and social services sectors. But OBA refines the targeting of subsidies by explicitly linking the payment of subsidies to the achievement of agreed outputs. OBA schemes can provide subsidies in three ways:

1. One-off subsidies: most OBA schemes in water, energy and telecommunications rely on one-off subsidies. Typically a one-off OBA subsidy is used to help connect a poor household to the water or electricity network or to reduce a community's contribution for provision of pay phones or Internet access.

2. Transitional subsidies: these can be used to support tariff reforms. A subsidy is used to fill the

gap between what the user is deemed able and/or willing to pay and the long-run marginal cost of the tariff. The subsidy tapers off as user contributions increase. Transitional subsidies are seen more often in countries with higher rates of access.

3. Ongoing subsidies: these normally fund the provision of basic services or maintenance in the roads, health and education sectors. For example, OBA road maintenance schemes require ongoing subsidies for the life of the road, often funded through road funds. As in the case of transitional schemes, ongoing subsidies should be paid out against pre-determined targeted outputs in order to be considered OBA.

The choice of subsidy design type depends on factors such as the sustainability of the funding source, the capacity for administering the subsidy scheme, the type of service to be subsidised, and the extent to which the service provider is willing and able to be paid over time.

Deciding when an OBA is suitable

The key pre-conditions for OBA suitability are outlined in Box D.3.

Experience shows that OBA takes stronger root-where contractual and regulatory practices are more supportive of the private sector taking risks. Although there are several cases of OBA with public sector providers, private sector operators are usually better structured to respond to performance-based incentives and to pre-finance outputs.

Box D.3. Pre-conditions for deciding the suitability of OBA ³

- Market structure and experience: transparent competitive processes and a minimum market of service providers with the technical capacity to sustainably deliver the services; financial and operational autonomy and/or access to commercial debt to take on financial and performance risks of delivering the outputs; and corporate governance and commercial orientation.
- Minimum legal and contractual requirements to support the development, monitoring and adjustment of contracts.
- Institutions that are able to enforce service provider obligations and to handle legal recourse/appeal for non-compliance with legal contracts and agreements.
- A regulatory framework that ensures minimum access and service levels for the poor.
- Proper tariff and subsidy policies to align incentives.
- Sector policies that include (1) service quality standards for specific categories of users; (1) provisions for the use of subsidies/grants to make services affordable to the poor; and (3) the participation of beneficiaries in the planning, design and service delivery.
- Clear government commitment and priorities (e.g. commitment to channelling sector funds through OBA to achieve sector goals).
- Local agencies capable of performing policy making, regulation, service delivery and oversight.
- An entity with adequate independence and capacity to verify outputs against the performance standards (or possibility for hiring an independent verifier).
- Capacity to target poor beneficiaries accurately using appropriate methodologies (e.g. means testing, geographic targeting, self-selection) so that subsidies benefit the intended recipients (e.g. lower income households).
- Sources of funds that have been agreed in advance (e.g. sector funds, or donors willing to contribute).

3. This section builds on GPOBA's work in progress on establishing an OBA diagnostic tool. Some of the factors outlined have been implemented in pilot projects while others are yet to be tested. Individual practitioners can decide which factors to apply in a specific context.

Lessons learned

Compared to traditional contracting approaches, the recent review of OBA projects shows that it is an efficient way of targeting subsidies and mobilising the private sector to serve poor households that would otherwise go without improved services,

such as those in remote areas. OBA has also demonstrated that monitoring for results is possible if appropriate systems for capturing and transmitting results are put in place. Other benefits of OBA are summarised in Table D.1.

Table D.1. Lessons from OBA projects

Benchmarks/criteria	Cross-cutting lessons from OBA portfolio
Increased transparency through the explicit targeting of subsidies	OBA provides a good platform for targeting infrastructure and social services subsidies. The focus on subsidies for access is inherently pro-poor: the poorest segments of the population often cannot afford initial access (for example, cost of connection, health insurance) and therefore often do not benefit from subsidies for ongoing service provision. Furthermore, if outputs are explicitly defined, targeting can be made more precise. The process of output verification can also provide an additional check on the targeting of subsidies and is helping provide early evidence that OBA schemes are reaching the poor.
Increased accountability by shifting performance risk to service providers	Compared to similar input-based schemes, OBA shifts performance risk to service providers by paying them only after delivery of verifiable access and service. However, the degree of performance risk shifted depends on the ability of the service provider to “pre-finance” investments and services until output-based payments are disbursed. Ultimately, access to finance will determine how much performance risk is reasonably shifted to the provider.
Increased engagement of private sector capital and expertise	OBA does leverage private funding, but because of its generally pro-poor nature, private financing leveraged is limited by the extent that user fees (for example, tariffs) can incorporate investment costs while remaining affordable. Particularly noteworthy are the examples where, through relatively small amounts of OBA subsidy, private sector expertise can be mobilised to extend services to customer segments the private sector might otherwise not reach. Ultimately, the effective use of private sector participation depends on the enabling environment – for example, the depth and quality of experience with public-private partnership contracts, regulation and access to finance.
Increased innovation and efficiency	Some evidence indicates that output-based payments have improved operational efficiency and the delivery of innovative, often pro-poor, services. Moreover, OBA has demonstrated efficiency gains through competition in most sectors when competitive pressures have been applied in the selection of the OBA service provider (although competitive tendering processes can take time). The focus on outputs rather than inputs should lead to innovations that translate into future efficiency gains, as has been seen in the ICT sector and to some extent in roads.
Increased sustainability of public funding	It is too early to say whether OBA schemes provide sustainable solutions in the long term. No evidence to date suggests that schemes involving OBA subsidies are less sustainable than input-based schemes. In fact, the design of OBA schemes can enhance sustainability. For example, the link between outputs and uptake encourages efforts at stakeholder participation and education through community organisations, NGOs, etc.
Improved monitoring of results and accountability	By paying for verified outputs, OBA internalises the monitoring of results. Ideally, the OBA monitoring platform can check aspects of service delivery other than outputs. OBA schemes also increase accountability for donors and governments: with public funding linked to outputs, waste or inappropriate allocation of such funding should be minimised.

Use of OBA in fragile states

In fragile states, OBA can enhance efficiency by focusing on performance in contracting out. However, as with other contracting-out arrangements in fragile states, OBA may not be suitable if local capacity or the institutional environment, or both, are too weak. The use of OBA in fragile states remains limited – except in the health sector, which has used OBA in a number of post-conflict situations. Fragile states are characterised by low capacity in government, civil society and the private sector. The negative impact of this poor capacity can be amplified by a complex and unpredictable political economy where competition for rents and influence can undermine service delivery. Furthermore, access to finance is generally limited, and therefore potential contractors may be less interested in performance/output-based contracts and unwilling to take on long-term responsibilities that involve investing their own funds in physical assets. In addition, providers may be concerned that the weak institutional framework will make the contracting process difficult, time-consuming and uncertain, and that payments will be delayed. This will put them at financial risk as contractors rely on government's capacity to manage and effectively monitor OBA mechanisms (for instance, NGO contracts). In these circumstances – and like other contracting out arrangements in fragile states – OBA may not be suitable.

However the success of contracting out health services on a performance basis in **Afghanistan** (Box D.3), the **Democratic Republic of Congo** (World Bank, 2005b, 2007) and elsewhere, show that OBA can lead to quicker and more comprehensive coverage in post-conflict countries compared to building up an input-based health system. Likewise, **Rwanda's** experience with output or performance-based provider-payment mechanisms suggests that alternatives to traditional input-based approaches may be more successful (Rusa *et al.*, 2009; Basinga

et al., 2010). However, to make output-based payments in post-conflict settings possible, the need for pre-financing usually needs to be relaxed. In such settings contracting out health services to private or non-profit providers generally involves a combination of block grants in the form of advance payments to allow start-up where payments are not directly tied to changes in outputs, and a performance-bonus based on key indicators. The World Bank's experience with OBA in two fragile countries – **Afghanistan** and **Chad** – in the health and road sectors is presented in Box D.3.

There are also some other examples of NGO-funded and implemented OBA projects:

- A new OBA pilot voucher scheme – Healthy Life – funded by Marie Stopes International was recently launched in **Sierra Leone**. It aims to increase access to the use of long-term and permanent family planning methods through a network of selected private sector clinics and pharmacies providing quality healthcare at an affordable price.
- The international NGO CORDAID has put in place provider-payment schemes in **Rwanda** and the **Democratic Republic of Congo** to subsidise priority health services, with payments tied to increases in service utilisation.
- In 1999 the government of **Cambodia** contracted out management of government health services to NGOs in five districts that had been randomly made eligible for contracting. The contracts specified targets for maternal and child health service improvement. Overall, the project was very effective in improving service delivery in the project area and there was also some evidence it improved health (Bloom Erik *et al.*, 2006).

Box D.4. OBA case studies from the World Bank Group**Basic health services in Afghanistan**

In 2003, the World Bank began the Health Sector Emergency Reconstruction and Development Project in Afghanistan. This included the Ministry of Public Health (MPOH) contracting out NGOs to provide a basic package of health services through performance-based partnership agreements. This strategy has been continued by a successor project that started in 2009. The NGOs receive performance bonuses worth up to 10% of their contracts if they perform satisfactorily on 10 health indicators. The MOPH prioritised monitoring and evaluation of health sector performance and contracted Johns Hopkins University to evaluate the performance of the NGOs.

Results are encouraging. There has been a 136% increase in the number of functioning primary health care facilities, while the proportion of those facilities with female health staff rose from 25% in 2002 to 83% in 2007. There has been a four-fold increase in the number of outpatient visits. The strong role of the Afghan Ministry of Health in defining and supervising the technical activities of the NGOs, as well as a commitment to measuring results, was important to the success of the strategy. In this example the government was capable and focused on technical/quality issues and outputs rather than on inputs and managing the funds and personnel directly.

Source: Mumssen et al 2010; and Project Task Team

Road improvement in Chad

In 1999, the Chad government formulated the National Transport Program to tackle the extreme isolation of large parts of the country and poor internal integration due to the lack of a backbone road network. It evolved from a more traditional input-based planning and contracting of maintenance to a more output-based approach known as an Output and Performance-Based Contract (OPBC), funded by the International Development Association. The competitive international tender was launched in late 2000 for a contract covering 441 kilometres of unpaved main roads (7% of the primary network) that were previously passable only during the dry season.

The OPBC contract was awarded for four years to DTP, a subsidiary of the French firm Bouygues, in early 2001. As long as DTP complied with the

service quality levels, it received a monthly fee of USD 480 per kilometre. This fee covered, among other things, fully rehabilitating the road and then managing and maintaining it for four years; monitoring compliance with the performance criteria; and providing basic aid in the event of road accidents. The contractor is paid for achieving predefined levels of service quality on the contracted road sections: passability, average speed attainable, user comfort and durability. Since the contractor bears all responsibility for designing, scheduling and carrying out works, it can decide what activities to undertake – and how, when, and where – to meet the required service levels and other performance specifications, thus enhancing innovation and efficiency. An independent consultant monitors compliance with these criteria monthly. If the contractor fails to comply with any of the service criteria in any one month, its fee is reduced.

Sources: Project Task Team Leader; and Hartwig, T, Y. Mumssen, and A. Schliessler (2005), "Output-based Aid in Chad: Using performance-based contracts to improve roads", OBAapproaches, Note 6, Global Partnership on Output-Based Aid, Washington DC

Conclusions

The specific advantages of OBA – targeting the poor, greater focus on results, sharing of risk by service providers, minimisation of waste or inappropriate allocation, and leveraging technical and financial capacity beyond the public sector – make it an attractive option for fragile environments. For instance, OBA can reduce financial risks by transferring the performance and operational risk to the service provider (who pre-finances the “outputs”) and paying the pre-agreed subsidy after the outputs have been independently verified. This provides both assurance and evidence to the donor that funds have been used for the intended purpose, as well as giving incentives to the contractor to operate efficiently and transparently. Although the use of OBA in fragile states remains limited, there have been some positive experiences. OBA can lead to quicker and more comprehensive health coverage in post-conflict countries than building up an input-based health system, particularly for services that are easy to deliver and measure. However, technical capacity-building must be provided to enable contractors to manage input procurement.

But because post-conflict countries have few resources, there must be some minimum conditions in place if OBA is to succeed. These include:

- The presence of strong private, community or non-profit providers
- Minimal staffing levels in service provider organisations
- The autonomy to recruit and dismiss personnel
- Well-designed performance-based contracts
- Strong government support and ownership

For OBA to be adopted more widely in fragile states, aid agencies need to shift from traditional project aid that uses complex centralised systems for financing inputs, towards aid approaches that are focused on outputs. Interventions will also need to be aligned with the country’s own goals. This may be more difficult (but not impossible, as the Chad example shows) to achieve in countries with particularly weak states.

Overall, as an integral part of a pro-poor infrastructure and social services delivery strategy, well-designed performance-based/OBA subsidy schemes could be particularly valuable where there are currently few incentives for performance.

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Glossary

Basic services

As embodied in the Millennium Development Goals, basic services are understood to include inter alia primary education, basic healthcare, water supply and sanitation.

Capacity

Understood as the ability of people, organisations and society as a whole to manage their affairs successfully.

Capacity development

Understood as the process whereby people, organisations and society as a whole unleash, strengthen, create, adapt, and maintain capacity over time.

Civil society organisation (CSO)

The multitude of associations around which society voluntarily organises itself and which represent a wide range of interests and ties. These can include community-based organisations, indigenous peoples' organisations and non-government organisations.

Contract

An arrangement in which a purchaser pays a third party to undertake a specified task set out in a formal agreement.

Contracting out

The transfer of competences and/or authority between a delegating authority (a purchaser) and a third party (a contractor), for a given period of time, based on a contractual agreement.

Core government functions and services

The OECD defines the core functions of the state as law enforcement and citizen protection, justice and conflict resolution, raising and expanding revenues, provision of basic services and facilitating economic development.⁴

Fragile state

A state is understood to be fragile when it is unable to meet its population's expectations or manage changes in expectation and capacity through the political process.

Line ministry

A government ministry or department with a sectoral function, as opposed to core, cross-cutting departments such as the Ministry of Finance, Prime Minister's or President's Office.

Memorandum of understanding (MOU)

An informal commitment between two parties to engage in collaboration and to undertake a certain tasks in the pursuit of common goals.

Non-governmental organisation (NGO)

A formally structured organisation that claims a philanthropic, non-profit purpose and is not part of a government.

Non-state provider

Providers of basic services that are not part of a government or state agencies, including large and small-scale for-profit enterprises and individuals, and non-profit NGOs, community and faith-based organisations.

4. OECD (2009), Bridging State Capacity Gaps in Situations of Fragility, Partnership for Democratic Development, OECD, Paris.

Output-based aid (OBA)

A financing mechanism to increase access to basic services – such as infrastructure, healthcare, and education – for the poor in developing countries. OBA is used in cases where poor people are being excluded from basic services because they cannot afford to pay the full cost of user fees such as connection fees. OBA is also known as “performance-based aid” or “results-based financing” (in the health sector). It is part of a broader donor effort to ensure that aid is well spent and that the benefits go to the poor. (World Bank, 2009).

Partner government

In international development terms, partner countries are those countries that are supported in implementing development measures through financial or technical co-operation with donor countries or organisations.

Paris principles

Refers to the outcome of the second High-Level Forum on Aid Effectiveness, held in Paris in February/March 2005. The Paris Declaration on Aid Effectiveness, from which the principles stem, is divided into three parts: I. Statement of Resolve, II. Partnership Commitments, and III. Indicators of Progress. The “Partnership Commitments” section contains the five core principles of the Paris Declaration: ownership, alignment, harmonisation, managing for development results (MfDR), and mutual accountability.

Performance-based contract (PBC)

A type of contract which provides incentives for good performance and sanctions for poor performance based on specified measurable outcomes.

Political risk

Refers to the risks that arise when the incentives for contracting out have not been adequately assessed, and a decision to contract out is taken without sufficient support or understanding amongst the key actors. Together with technical risk, these are the two main categories of risk associated with a decision to contract out.

Public-private partnerships (PPPs)

Arrangements in which a state service is funded and operated through a partnership between the state and one or more organisations outside the public sector. They are mutual commitments over and above that implied in any contract and, unlike contracting out, may have no legal basis. PPPs often involve private sector investment or commercial control over assets. They encompass a much broader range of collaborations and alliances between the public and private sector than contracting out.

Private sector

Small and large-scale commercial providers, but sometimes used interchangeably with non-state providers to include NGOs.

Procurement

The purchase (in this case by government) of goods and services. It differs from contracting out in that contracting out has many elements, just one of which is procuring (purchasing) the services of a particular contractor.

Rent seeking

An activity undertaken by an individual to enrich himself or herself by controlling a scarce resource (*e.g.* land, minerals) without contributing anything of value. When a public official enriches himself or herself by manipulating his or her discretion over government decisions (*e.g.* in granting licences), it is a form of corruption.⁵

Service provider

Any state or non-state provider of basic services.

Service recipient

The intended beneficiary of a service.

Stakeholder

A person or a group with an interest in an organisation, project or event.

Technical assistance

The personnel involved (individuals as well as teams of consultants) in developing knowledge, skills, technical know-how or productive aptitudes.

Technical co-operation

Activities whose primary purpose is to augment the level of knowledge, skills, technical know-how or productive aptitudes of the population of developing countries, *i.e.*, increasing their stock of human intellectual capital, or their capacity for more effective use of their existing factor endowment.

Technical risk

Refers to the types of risk that arises when there are gaps in the capacities, systems, information and markets required for contracting out. In the event that technical risk is not adequately mitigated, it can generate political risk (see above).

5. Vian, T., Savedoff W. and Mathisen, H., 2010, *Anticorruption in the Health Sector: Strategies for Transparency and Accountability*, Kumarian Press, Sterling (Virginia).

The contracting out of government functions and services to external providers is an established practice in many developed and developing countries. On the one hand, it can offer essential support to states that have to deliver basic services urgently; on the other, it risks bypassing governments and undermining their long-term recovery. The OECD's Partnership for Democratic Governance was formed in 2007 to gather evidence on this issue.

This handbook does not take a view for or against contracting out; nor is it a technical manual. The handbook is for field practitioners and government policy makers in countries that are either emerging from conflict or are otherwise considered to be fragile. Its aim is to help them make more informed choices about the types of contracting that are best suited to their country. It is a tool to assess whether contracting out might be a possible way forward – either temporarily or over a longer period of time – for delivering a core service (such as basic education, healthcare, water and sanitation) or a government function (such as managing public finances and human resources). The handbook illustrates these points with the aid of case studies ranging from Afghanistan to Haiti and Liberia.



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