VALUE FOR MONEY IN CAPITAL BUDGETING AND PROCUREMENT PRACTICES

World Bank Institute Global Roundtable on Value for Money in Public-Private Partnerships

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BETTER POLICIES FOR BETTER LIVES

Agenda

1. Introduction and definition
2. Volumes and performance
3. Budgeting and accounting systems
4. The procurement cycle and institutional roles
5. Procurement and Value for Money
6. Some recommendations

Table numbers refer to P. Burger & I .Hawkesworth ‘Capital budgeting and procurement practices’ presented to the OECD Annual Network Meeting of Senior Public-Private Partnership Officials 15-16 April 2013. It will be published in the OECD Journal on Budgeting.

1. Introduction

- Key question: How to attain value for money?
- Key message: By ***aligning*** the system towards attaining it (**budgeting, accounting, institutional, absolute and relative, culturally**). This requires ***integrating*** PPP and traditional infrastructure procurement.
- Why? Because the ***main barriers*** to VfM are the wrong incentives, a lack of appropriate roles and responsibilities being maintained, the wrong tools.
- HMT: the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user's requirement. VfM is not the choice of goods and services based on the lowest cost bid.
- NN 'What experienced experts agree represents the best chance of meeting the specified needs at the lowest price.'

VOLUMES AND PERFORMANCE

3. Less than 15% of investment flow

Table 1. For the 2011 fiscal year, what percentage of public sector infrastructure investment flow (total asset value, public and private components included) took place through PPPs?

Australia	>10% - 15%	**Korea**	>5% - 10%
Austria	No PPPs	**Luxembourg**	>5% - 10%
Canada	>1% - 3%	**Mexico**	>15%
Czech Republic	>0% - 1%	**New Zealand**	>1% - 3%
Estonia	No PPPs	**Norway**	>3% - 5%
Finland	>10% - 15%	**South Africa**	>3% - 5%
Germany	>3% - 5%	**Spain**	>3% - 5%
Hungary	No PPPs	**Sweden**	No PPPs
Italy	>1% - 3%	**Switzerland**	No PPPs

PPPs outperform TIP on timeliness, construction cost and quality but transaction costs are higher

Table 3. Based on the general experience of your government, how do PPPs perform relative to traditional infrastructure procurement with regard to the following dimensions?

	Better than TIPs	The same as TIPs	Worse than TIPs	Not enough data
Timeliness e.g. being completed on-time/according to projected deadline	14	1	0	2
Construction cost e.g. projects completed on or under expected budget	12	2	0	3
Operating cost e.g. projects operate on or under expected budget	7	3	1	5
Quality of the finished project e.g. projects comply with code, innovations, etc.	10	3	0	4
Transaction costs	4	1	7	4

PPPs outperform on construction costs

- **Table 4. In the experience of your government in most TIP and PPP projects in the period 2002-2011, to what extent do ex ante, projected construction costs deviate from the realised construction costs of projects?**

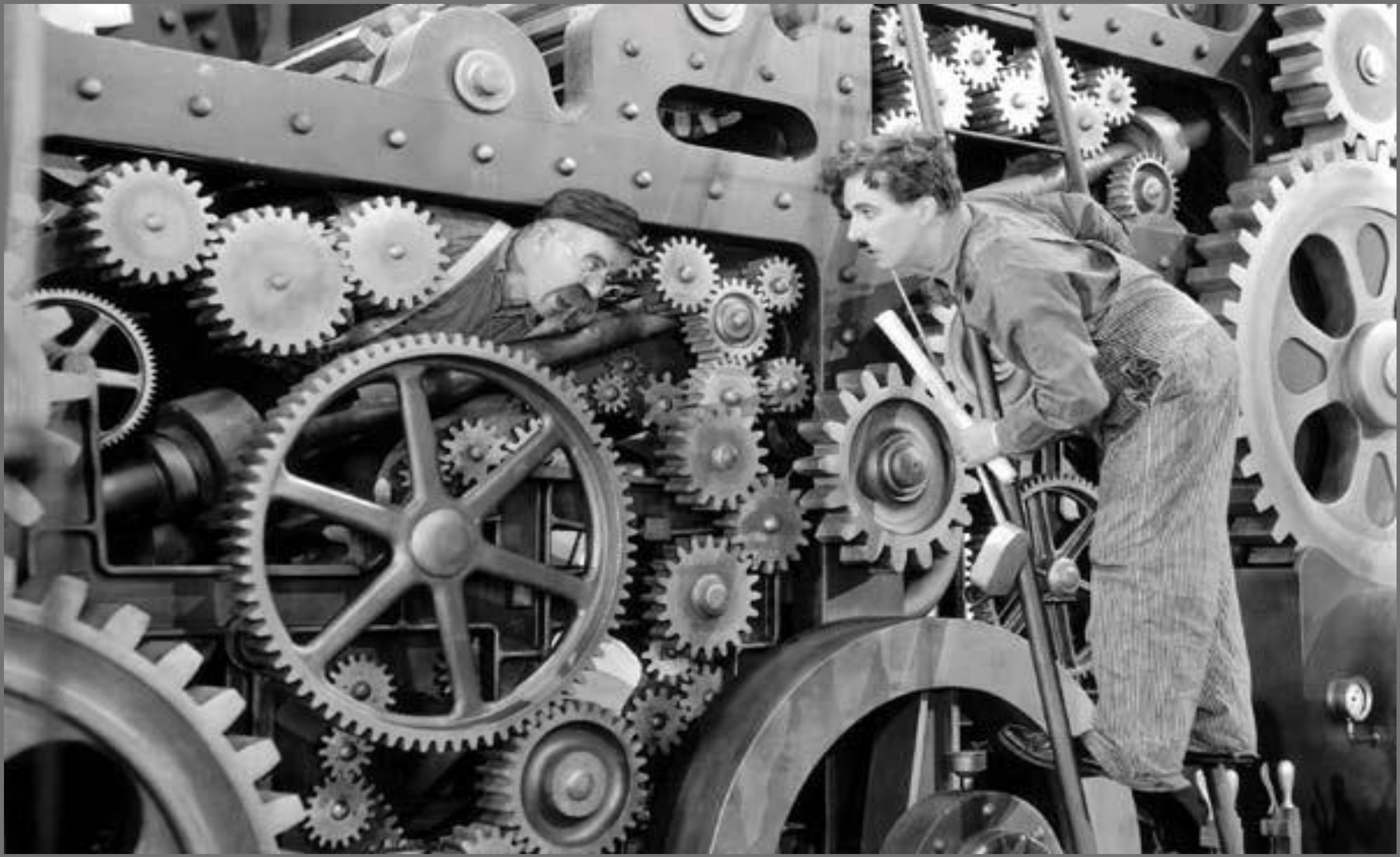
	PPPs	TIP
Realised cost is lower than projected cost by less than 10%.	2	0
Realised cost does not deviate from projected cost.	4	2
Realised cost is higher than projected cost by less than 10%.	2	4
Realised cost is between 10-29% more than the projected cost.	1	4
Realised cost is between 30-49% more than the projected cost.	0	2
Realised cost exceeds the projected cost by 50% or more.	0	0
Too little data to tell.	6	9

The message is less clear with regards to operating costs

Table 5. Given the experience of your government in most TIP and PPP projects in the period 2002-2011, to what extent do ex ante, projected operating costs deviate from the realised operating costs of projects?

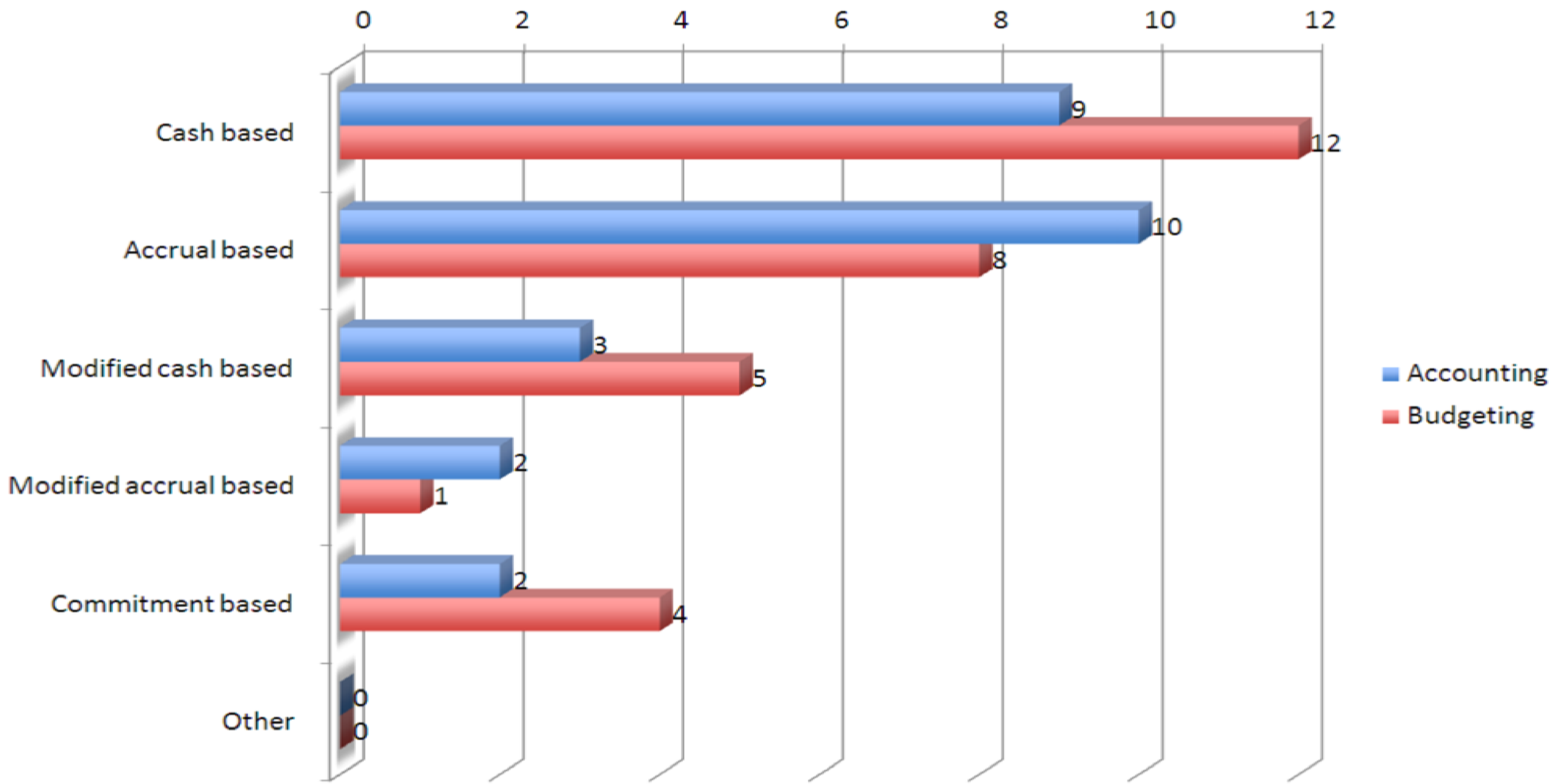
	PPPs	TIP
Realised cost is lower than projected cost by less than 10%.	0	0
Realised cost does not deviate from projected cost.	3	1
Realised cost is higher than projected cost by less than 10%.	2	2
Realised cost is between 10-29% more than the projected cost.	0	0
Realised cost is between 30-49% more than the projected cost.	0	1
Realised cost exceeds the projected cost by 50% or more.	0	0
Too little data to tell.	10	15

BUDGETING AND ACCOUNTING SYSTEMS



Cash is still king, but accruals is catching on

Figure 4. What is the basis for your government's accounting (of realised transaction) and its budgeting (of prospective transactions)? (More than option possible)



Most distinguish between the two types of expenditure but use a unified budget.

Capital budgeting

a. Make no distinction between capital and current expenditure?	
Korea	Norway
Netherlands	Sweden
Total: 4	
b. Distinguish between capital and current expenditure, but in doing so, uses a unified budget (i.e. a budget that contains both capital and recurrent expenditure)?	
Australia	Italy
Austria	Japan
Brazil	Luxemburg
Canada	New Zealand
Czech Republic	Slovakia
Estonia	South Africa
Finland	Spain
Germany	Switzerland
Hungary	
Total: 17	
c. Use a dual system, i.e. where there are altogether separate budgets for capital and current items?	
Mexico	UK
Total: 2	

Funding happens annually

- **Table 9. If your government uses a cash-based, modified cash-based or commitment-based system to appropriate funding in the annual budget, does it allocate construction costs in the following manner?:**

a. Total cost is appropriated in the first year and subsequently carried over until the project is completed.	
Finland	
Total: 1	
b. The cost is appropriated annually according to the project plan.	
Brazil	Mexico
Canada	Netherlands
Czech Republic	Norway
Estonia	Slovakia
Germany	Spain
Hungary	Sweden
Korea	Switzerland
Luxemburg	
Total: 15	
c. Not applicable since your government only uses an accruals-based system.	
Australia	UK
New Zealand	
Total: 3	

Assessment of contingent liabilities needs more work

Table 10. Does the budget documentation or other published material contain an assessment with respect to contingent liabilities derived from:

	PPPs	SOEs, Agencies and private incorporated businesses
a. Yes, they are listed but not priced	3	3
b. Yes, they are listed and priced	4	3
c. No	11	11

THE PROCUREMENT CYCLE AND INSTITUTIONAL ROLES

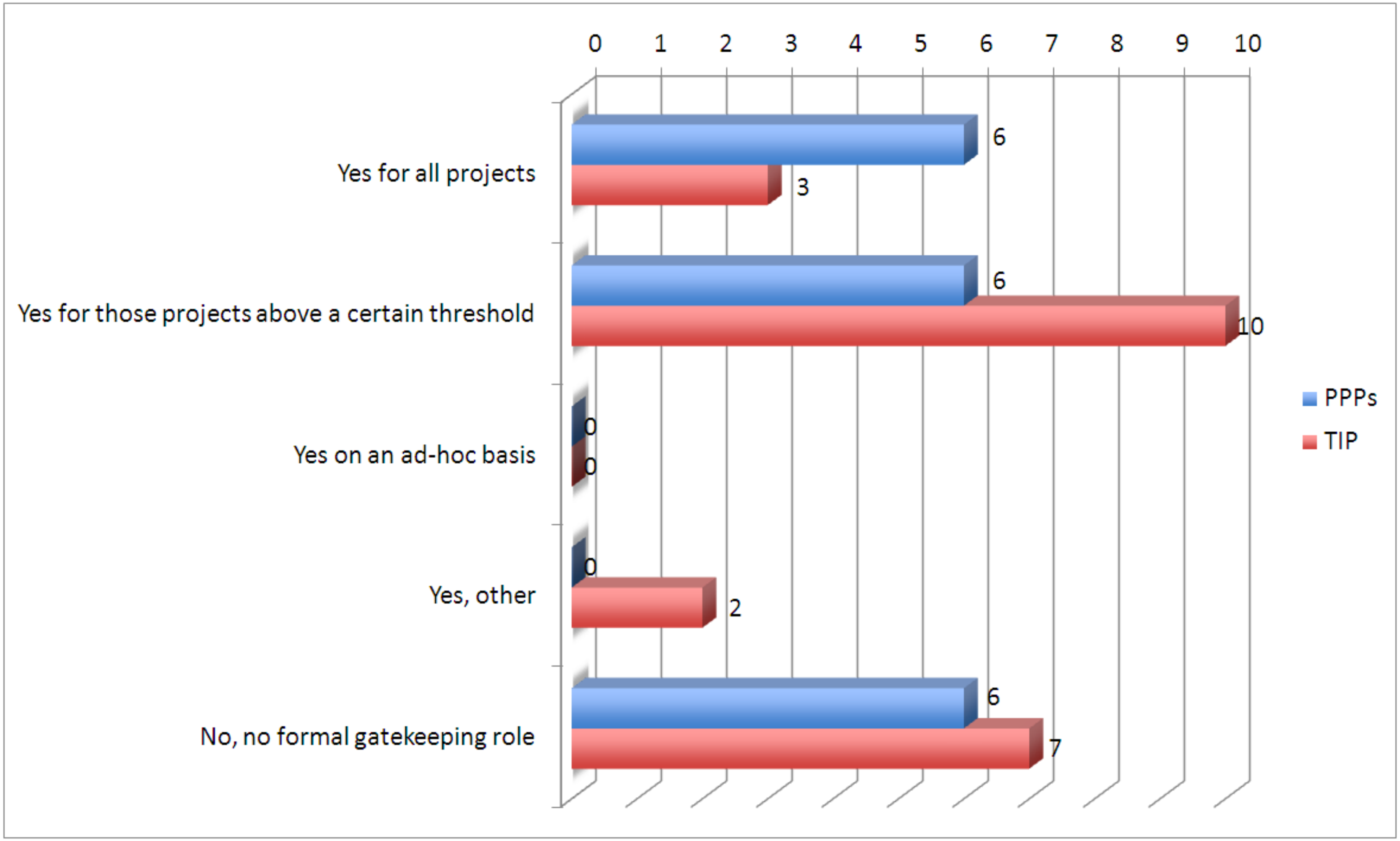
Table 11a. Please select the primary actors responsible for each of the below activities. Select maximum three actors per row.

	Prioritisation of all infrastructure /capital projects	Needs assess-ment	Consultation about project outputs	Ex ante value for money analysis	Planning and budgeting proposal	Dispute resolution
a. Chief Executive or elected governing body	12	8	4	1	3	8
b. Legislature or Legislative body	8	2	1	1	1	1
c. Central Budgeting Authority	9	6	6	8	15	6
d. Ministry responsible for capital projects	18	21	18	15	21	11
e. Executive Agency for infrastructure answering to Ministry	7	8	11	12	10	6
f. Private consultants	0	2	6	9	1	1
g. Civil society organisations	2	1	4	2	2	1
h. Supreme Audit Institutions	1	2	2	1	1	1
i. N.A. (e.g. activity does not take place)	1	0	0	1	0	3

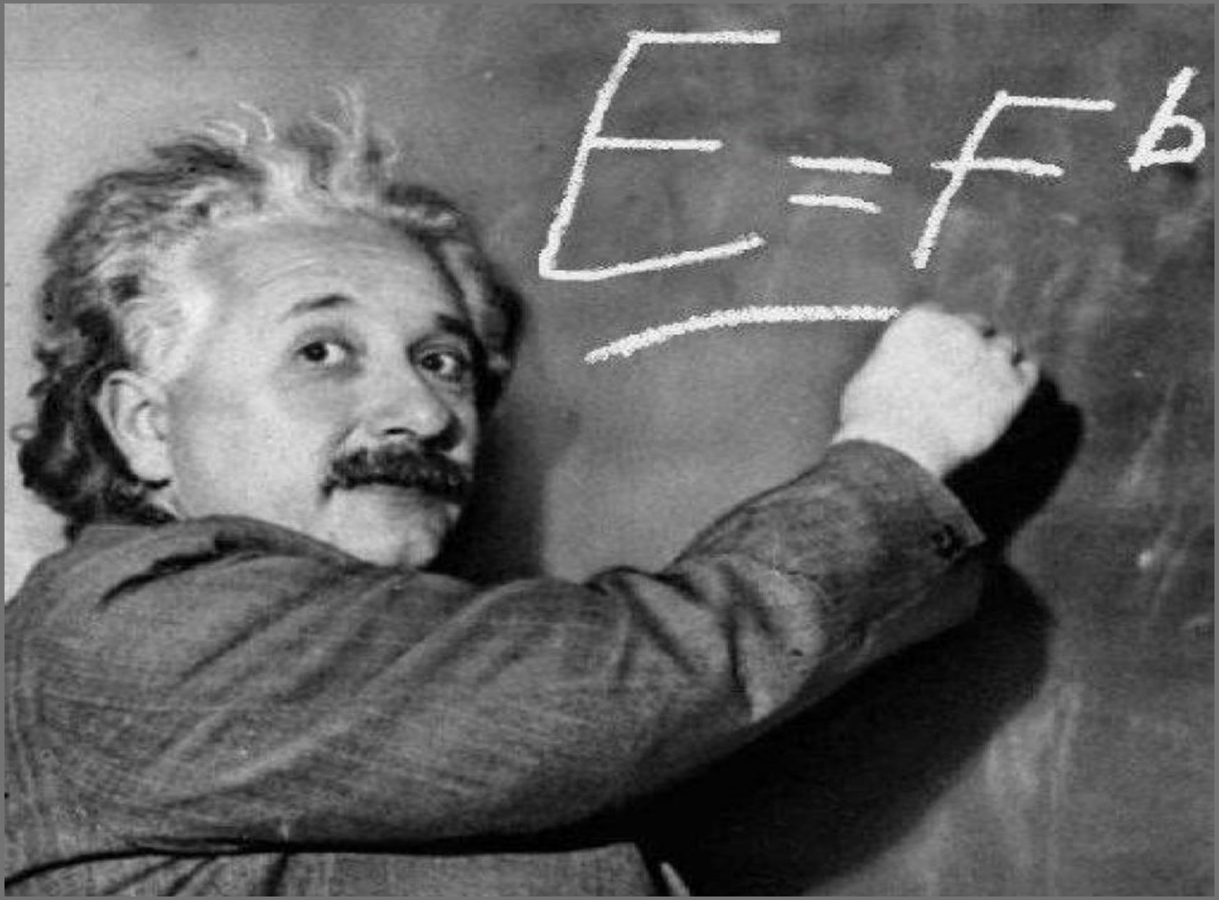
Table 11a. Please select the primary actors responsible for each of the below activities. Select maximum three actors per row.

	Monitoring project execution	Ex post evaluation	Deciding whether PPPs or TIPS are more adequate	Determining rules for PPPs	Procurement for PPPs
a. Chief Executive or elected governing body	4	2	8	5	2
b. Legislature or Legislative body	1	0	2	4	1
c. Central Budgeting Authority	7	4	12	11	4
d. Ministry responsible for capital projects	18	17	17	9	11
e. Executive Agency for infrastructure answering to Ministry	13	11	5	3	4
f. Private consultants	4	4	3	1	5
g. Civil society organisations	1	1	0	0	2
h. Supreme Audit Institutions	6	12	1	2	0
i. N.A. (e.g. activity does not take place)	0	0	2	3	6

The Central Budget Authority is required to approve capital/infrastructure projects of line ministries (even when these projects fall within the existing budget envelope)?



PROCUREMENT AND VFM



6. Planning, prioritisation and ensuring value for money

Figure 9. Absolute and relative value-for-money assessment

Cost-benefit analysis (considers absolute value for money and compares the value for money of alternative options for projects relative to each other)

Road	Rail	Higher toll on existing road	etc…	
Road project delivered through TIP	Road project delivered through TIP	Government charges a higher toll		**TIP**
Road project delivered through a PPP	Road project delivered through a PPP	A private operator charges a higher toll		**PPP**

Public sector comparator (considers the value for money of procurement options relative to each other)

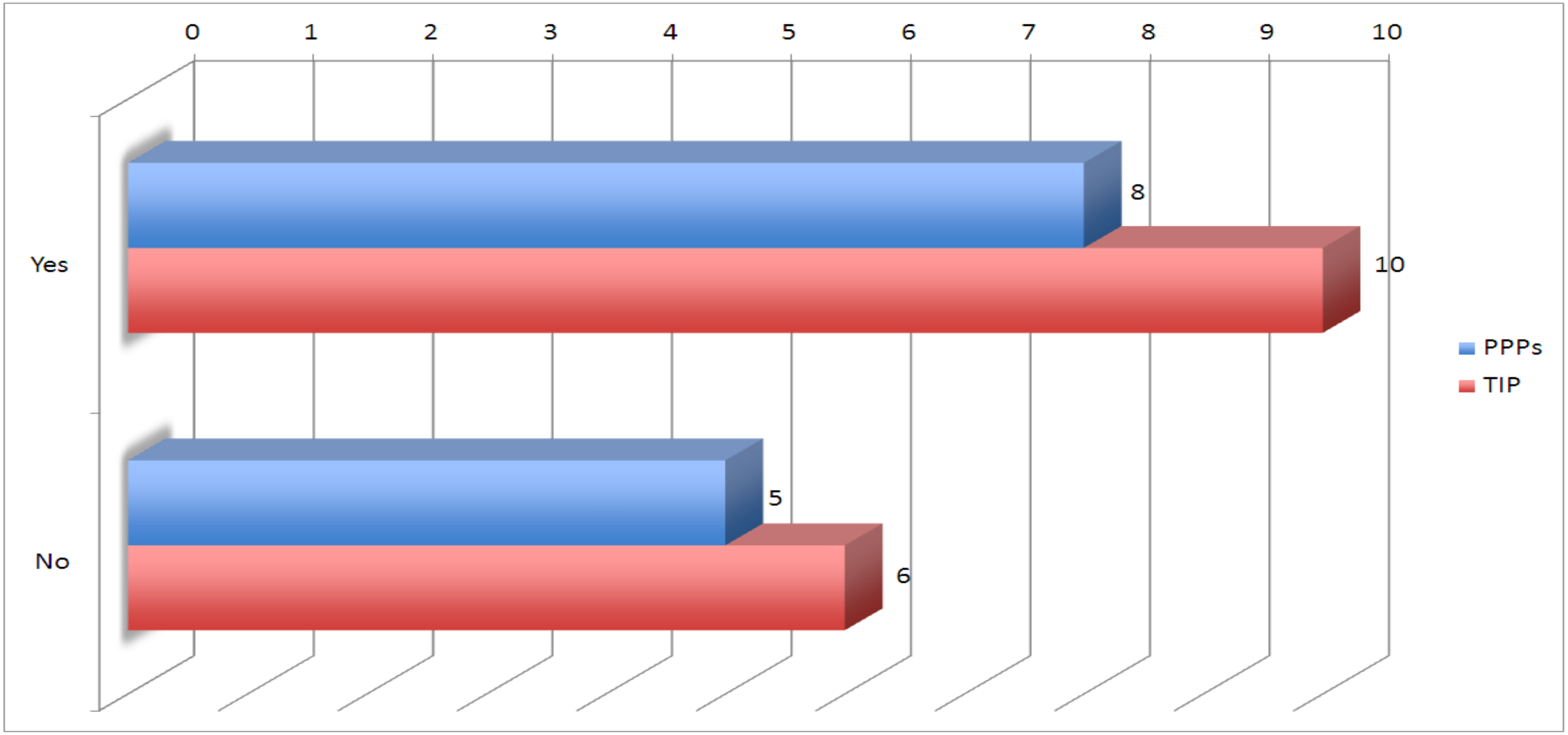
VfM tests are usually used, but more so for PPPs

Table 13. In general, does your government apply an absolute value-for-money analysis (such as a cost-benefit or cost effectiveness analysis) and/or relative value-for-money analysis (such as public sector comparators) that takes a whole-of-life (net present value) approach to prospective capital projects? (Select the most relevant option.)

Absolute value-for-money assessments (e.g. cost-benefit analysis)	PPPs	TIP
Yes, for all projects	8	5[1]
Yes, for all those above a threshold	2	7[1]
Yes, on an ad hoc basis	4	9
No	2	1
Other	3	4
Relative value-for-money assessments for PPPs (e.g. public sector comparator)	**PPPs**	
Yes, for all projects	12	
Yes, for all those above a threshold	3	
Yes, on an ad hoc basis	1	
No	1	
Other	2	

Optism bias countermeasures are increasingly used for both forms

- Figure 11. In the value for money test that your government uses for TIP and PPP projects, does it explicitly include an estimate for optimism bias (optimism bias means the tendency for ex ante assessments to underestimate the cost and time it will take to complete a project)?



General support for VfM tests, perhaps overly generous?

- **Table 15. Which one of the following two options best describes the experience of your government with value-for-money analysis for projects?**

Absolute value-for-money assessments (e.g. cost-benefit analysis)		**PPPs**	**TIP**
They really contribute towards better decision-making	Yes	12	16
	No	1	1
In general, they create a false impression of precision and management rigour	Yes	1	0
	No	5	7

Relative value-for-money assessments for PPPs (e.g. public sector comparator)		**PPPs**
They really contribute towards better decision making	Yes	14
	No	1
In general they create a false impression of precision and management rigour	Yes	0
	No	6

The decision to invest is different from the decision to procure

- **Table 17. Does the government first decide on the procurement of an asset (which would include an assessment of its affordability) before it considers the choice between PPP procurement and TIP**

	PPPs	**TIP**
Yes always (100% of the time)	11	11
Yes very often (>75, but <100% of the time)	3	5
Yes often (>50-75% of the time)	1	0
Yes sometimes (>25%-50% of the time)	0	0
Yes rarely (>0, but <25% of the time)	0	0
No, not required	1	2
Other, please specify	3	3

SOME RECOMMENDATIONS

Recommendations for capital budgeting and procurement practices

- ***The government should, irrespective of whether a project is a TIP or PPP project, budget the full capital cost upfront***. In the case of a TIP project, the full capital cost is the direct capital cost, while in the case of a PPP it is the present value of the capital component of all future user charges to be paid to the private partner.
- ***The government should budget the full capital cost upfront for all investment projects delivering a public service by SOEs where the government carries a contingent liability.***
- ***All debt of entities such as PPPs and SOEs*** that might impact government debt should be ***recognised explicitly and included in the assessment of fiscal sustainability***.
- With respect to *SOE investments where the government guarantees the debt of the issue*, ***the contingent liability of government should be added to public debt*** to assess the *sustainability of fiscal policy*.
- ***All possible capital projects should be subjected to a needs analysis, an initial feasibility as well as an initial assessment of affordability***.

Recommendations for capital budgeting and procurement practices

- ***The prioritisation of projects should be synchronised with the budget cycle.*** This will require specific procedures to ensure the synchronisation occurs.
- ***The*** **ex ante** ***value for money assessment should take a whole-of-life approach. The initial affordability assessments of those projects that pass the*** **ex ante** ***value for money assessment should be revisited*** to establish whether they are still affordable and to reconsider the prioritisation of projects done in the initial affordability assessment..
- ***All projects, or at least all projects above a threshold, should include as part of their cost estimates an element that reflects the typical 'optimism bias' experienced in projects***.
- ***When using PPPs to deliver services, it is advisable that governments apply procurement option pre-tests as well as relative value-for-money assessments such as PSC to support the pursuit of maximum value for money.***
- ***Government should conduct*** **ex post** ***value-for-money assessments.*** These value-for-money assessments should compare realised outcomes with the *ex ante* value-for-money assessments to establish whether or not there has been deviations.

THE MAIN MESSAGE, AGAIN

The main message again

- Key question: How to attain value for money?
- Key message: By **aligning** the system towards attaining it (budgeting, accounting, institutional, process, culture). This requires **integrating** PPP and traditional infrastructure procurement.

Thanks!

For more information:

- **www.oecd.org/gov/budget/ppp**.
- OECD Principles for Public Governance of PPPs (2012)
- **Ian.Hawkesworth@OECD.org**