

The Quality Infrastructure Principles and its Operational Application to Value for Money Analysis

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Summary of Presentation

The purpose of a Value for Money (VfM) assessment is to indicate if a project would be more efficient under a Public-Private Partnership scheme or under some other procurement method. VfM assess the project from the perspective of the procuring authority and considering the broader interests of society. It is the optimum combination of life-cycle costs and quality (or fitness for purpose) of a good or service to meet the user's requirement. VfM answers the question, which delivery method provides the 'best deal' for implementing a specific project from the perspective of the government. It should create an understanding of the differences between PPP and other delivery methods and contribute to a better understanding of the potential value drivers of the PPP option. The VfM assessment provides the government with an approximate quantitative range of outcomes, sensitivity analysis and risk analysis to determine the robustness of the outcomes, and qualitative considerations.

The key message of the presentation is to recognize that effective infrastructure governance, along the lines of the Quality Infrastructure Principles of the G-20, is necessary to achieve VfM. In other words, regardless of the rigor of the various VfM techniques, guidance and analyses, they will not be successful in achieving VfM if the overall infrastructure governance is flawed. Infrastructure governance comprises the public institutions, processes and procedures that guide government decisions in planning, allocating funds and implementing public investment projects, including PPPs. It covers the entire life cycle of the asset, but the most resource intensive activities will typically be the planning and decision-making phase for most infrastructure assets. The objective of the project governance framework is defined by the OECD as "... to ensure that infrastructure programmes make the right projects happen, in a cost-efficient and affordable manner, that is trusted by users and citizens to take their views into account." ¹

At a time when infrastructure PPP could support economic recovery after COVID-19, the global level of PPP transactions is declining – on a widespread basis. Globally, PPP transactions have fallen from 2010 to 2019, while in the Asia-Pacific region it dropped from \$46.8 billion to \$33.8 during the same period. ² The evidence that PPPs produce VfM is very ambivalent at best. An audit of all UK PPPs failed to show VfM, due largely to a lack of data especially on the government projects³. A survey of policy makers in South East Asian countries revealed only between 10 to 20 percent viewed PPPs as producing more VfM than traditional public procurement. ⁴

The impact of COVID 19 in 2020 caused delays in the implementation of PPPs, which in turn leads to increased costs and raises the risk of renegotiation of PPP contracts. In Asia and the Pacific, for example, 27% of PPP projects reported delays.⁵ As noted in a recent ADB blog, "Renegotiation is already

¹ Towards a Framework for the Governance of Infrastructure", OECD, 2015

² World Bank PPI data base

³ National Audit Office, (2013), "Review of the VfM assessment process for PFI", Briefing for the House of Commons Treasury Select Committee

⁴ Governments at a Glance in South East Asia, ADB and OECD, 2019

⁵ World Bank Survey Data, June 2020 (unpublished)

a fraught issue in many jurisdictions and poses a challenge to the overall value for money if projects are not carried out transparently.”⁶

Total global estimates for infrastructure investment to maintain growth between 2019-2030 in emerging markets is around \$12 trillion, and the Asia Pacific region will need to invest around 5 percent of GDP over this same period. ⁷ A 1% increase in infrastructure spending has a multiplier effect of 1.4 over 4 years, though the correlation of growth to infrastructure spending is not as strong in developing countries compared to advanced economies⁸ But with resources tight, governments need to spend taxpayer money wisely on the right PPP projects. For this, countries need to implement VfM within a system of good infrastructure governance—strong institutions and frameworks to plan, allocate, and implement PPP infrastructure.

The G20 leaders affirmed the call for quality infrastructure through the endorsement of the Quality Infrastructure Investment Principles (QII) at the G20 Finance Ministers’ and Central Bank Governors’ Meeting in Japan (8–9 June 2019). According to the Principles, raising economic efficiency involves appraisal of a project considering Value for Money (VfM), life-cycle costs, fiscal sustainability, affordability, risk assessment, allocation and mitigation, resiliency against natural disasters and climate impacts, as well as innovative technology with the potential to be more cost-effective and resilient. Since then, the ADB Replenishment and the IDA replenishments have included support to developing countries to implement QII principles in the planning, design and implementation of infrastructure projects.

Every dollar spent must count, and when spending more on infrastructure, countries also need to spend better and smarter to get the most bang for the buck. Infrastructure investment efficiency is the ratio of the capital stock of infrastructure investment per capita to indicators measuring the quality of and access to infrastructure. According to the IMF, The Asia Pacific region has an average gap of 32% in public investment efficiency, around the average for developing countries and below the level of Europe which has an average of a 21 % gap in infrastructure efficiency. The least effective public investment management institutions are those involved in appraising and selecting projects, maintenance funding, multiyear budgeting, and monitoring of public assets, and management of project implementation. The good news is that efficiency losses and wasteful spending in infrastructure are not inevitable and countries can reverse this through better infrastructure governance practices.⁹

Despite the prevalence of PPP units and use of VfM in Asia, few countries adapt the best practice to separate the investment decision from the procurement decision. Most countries in the Asia Pacific carry out VfM for traditional investment projects and for PPPs.¹⁰ All projects should be subject to selection criteria based on fit with government policy priorities, cost benefit, fiscal and debt constraints, and funding space within the medium-term budget framework. This results in an “investment decision”.

⁶ ADB Blog, Another COVID-19 challenge: Saving Asia’s crucial infrastructure deals, by Hanif Rahemtulla, Srinivas Sampath, Colin Gin

⁷ Well Spent, How Strong Infrastructure Governance and End Waste in Public Investment, IMF 2020

⁸ Source Global Infrastructure Hub, Presentation to G-20, 2020

⁹ : IMF Public Investment Management Assessment missions, 2015-2019

¹⁰ Source: Benchmarking Infrastructure Procurement, World Bank, 2020

Once the government decides that a project is worth procuring, it then decides how best to procure the project. This “procurement decision” involves deciding which method of procurement – PPP or a more traditional form - is most likely to deliver Value for Money. Governments should not treat PPP projects differently than other public investment projects that are part of the public investment management plan. Moreover, governments should treat PPP liabilities as if it is a traditional investment project. Payments and contingent liabilities should be in the government budgets accounts, since the government is the economic owner of a PPP and ultimately responsible for the delivery of the infrastructure service. Failure to do this results in a “fiscal illusion” by not recognizing fiscal liabilities.

It is during the Appraisal Phase that the government determines if a project is likely to deliver VfM and a recommendation made prior to the structuring phase. VfM should ideally not be a one-time exercise. Project teams should update the VfM over the course of the project cycle as you update data from initial pre-feasibility studies with more robust data from more detailed feasibility studies. VfM assesses the results of technical, economic, commercial, fiscal, environmental, social and climate feasibility assessments. After completing the initial in the appraisal phase, it is advisable to update the VfM exercise after award of the project in order to check for modifications made during the Structuring Phase to ensure the maintenance of VfM. It is useful to carry out an ex-post evaluation of VfM during contract management and implementation of the project, especially in cases in which the authorities have agreed to modify the contract for whatever reason, or if a contract extension or renegotiation occurs. Developing the Value for Money exercise is thus a progressive effort in at least four different stages of the PPP process (appraisal, procurement, structuring and ex-post management phase)– in the latter phase after award it mainly a lesson learned exercise.

The first step in a VfM analysis to produce a raw public sector comparator (PSC). This refers to the estimate of the whole-life costs of the project if the government implements the project as a traditional procurement. The next step is to turn the raw PSC into an Adjusted PSC for fair comparison with a PPP. The justification for the risk adjustment is because the two cash flows need to reflect, as far as possible, identical risk profiles. The next step is a competitive neutrality adjustment. Some countries adjust the PSC to neutralize the cost advantages of the implementation of a project by a public body that are only apparent, and do not reflect effective efficiency gains. The most common adjustment is the addition to the PSC of a taxes, simulating the same tax regime of the private partner. The fiscal impacts should also include the cost to the government of project management and transaction implementation. These regulatory costs refer to agencies’ extra staff required or independent construction certifiers. The project team should add this to the PPP costs whenever they are exclusively related to overseeing the PPP alternative. The final step is to apply the comparison of the Net Present Value (NPV) of each alternative- the PPP and the public option – and applying a discount rate to the projected costs. Once the government contracting authority has reduced the PSC and PPP alternatives to one Net Present Value, the final step is to indicate which one represents a positive value for money and the best alternative to implement the project.

Typically, the quantitative VfM assessment is very much based on unproven assumptions. Not only the valuation of risks and cost estimates, but also the adjustments made to PSC and the discount rate are estimates with a considerable level of inaccuracy. Therefore, its conclusions are for reference only; the project team should do a sensitivity analysis on the numerical recommendation, and a qualitative analysis should follow the quantitative analysis to ensure a PPP model is appropriate and to assess non-quantitative issues such as government intuitional capacity to implement a PPP effectively.su:

A positive Value for Money (VfM) does not necessarily imply that the best option is a PPP route; qualitative factors should be a part of the decision as well. A negative Value for Money (VfM) does not mean that a PPP route is worse than traditional procurement. Under these circumstances, many governments are skeptical of the use of the VfM methodology as a scientific pass or fail test, which is why some countries choose not to use it altogether. However, taken as a reference only, in combination with a qualitative analysis, the tool is useful to indicate the capacity of the PPP to increase efficiency in infrastructure delivery and to check whether the general concept of the project fits the PPP model.