

A Governance Approach to Value for Money Analysis

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Organization and Objectives

Why Governance Matters for VfM

What the data says about the role of infrastructure investment and PPPs in economic recovery. Discuss how QII Principles and infrastructure governance sets the framework for VfM. Evidence is presented on if PPPs really deliver on VfM.

How to Conduct VfM

The section presents the need for a qualitative approach and risk assessment to supplement quantitative analysis. The objective is to gain an understanding of VfM by guiding participants through a VfM analysis

A Governance Approach to VfM

Discuss the role of the enabling economic and sector environment and institutional framework to improve public investment and financial management. The objective is to provide participants with an understanding of the criticality of infrastructure governance to achieve VfM.



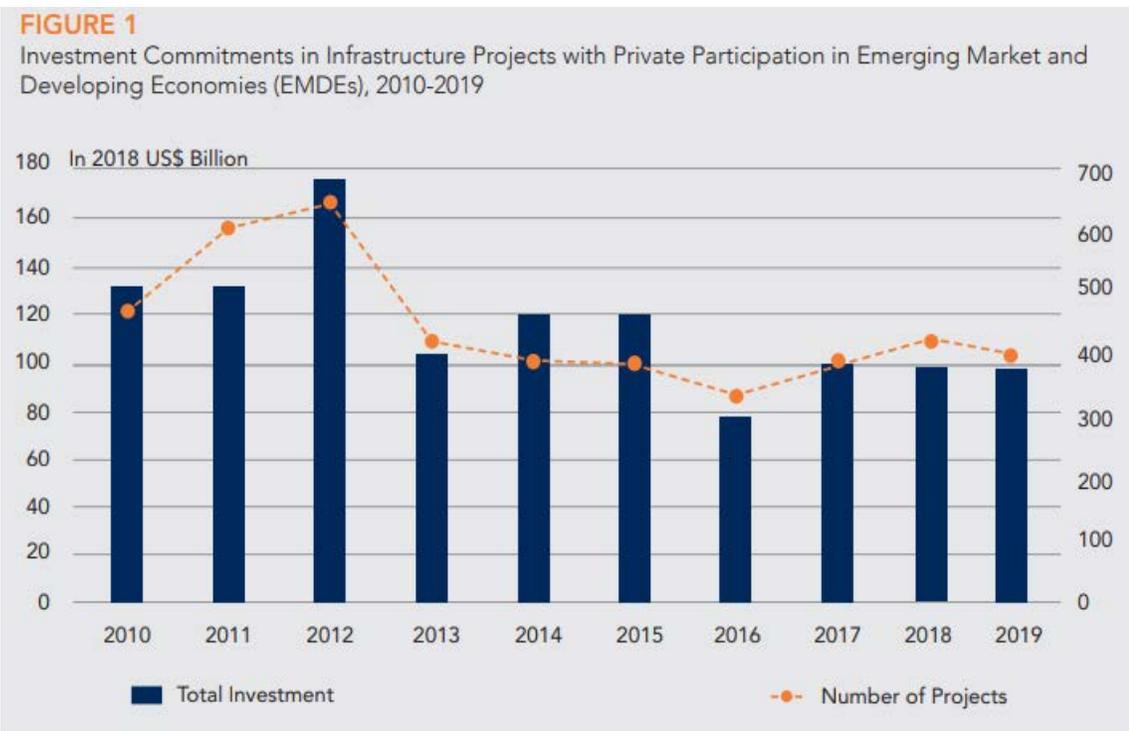
Value for Money Definition

Value for Money evaluates if a project would be more efficiently implemented under a PPP scheme or under some other procurement method, from the perspective of the procuring authority and considering the broader interests of society.

The VfM assessment provides the government with:

- ✓ A quantitative range of VfM outcomes
- ✓ Risk analysis to determine the robustness of the outcome compared to a public sector comparator
- ✓ Qualitative considerations

Decrease in PPP Projects and Economic Growth



Source: PPI Annual Report, PPIAF

| | 2020 | | | 2020 | |
|------------------------|------------|---------------|-----------------------|-------------|---------------|
| | ADO | ADOU | | ADO | ADOU |
| East Asia | 2.0 | 1.3 ▼ | South Asia | 4.1 | -6.8 ▼ |
| Hong Kong, China | -3.3 | -6.5 ▼ | Bangladesh | 7.8 | 5.2 ▼ |
| PRC | 2.3 | 1.8 ▼ | India | 4.0 | -9.0 ▼ |
| Republic of Korea | 1.3 | -1.0 ▼ | Pakistan | 2.6 | -0.4 ▼ |
| Taipei,China | 1.8 | 0.8 ▼ | | | |
| Southeast Asia | 1.0 | -3.8 ▼ | Central Asia | 2.8 | -2.1 ▼ |
| Indonesia | 2.5 | -1.0 ▼ | Azerbaijan | 0.5 | -4.3 ▼ |
| Malaysia | 0.5 | -5.0 ▼ | Kazakhstan | 1.8 | -3.2 ▼ |
| Philippines | 2.0 | -7.3 ▼ | | | |
| Singapore | 0.2 | -6.2 ▼ | The Pacific | -0.3 | -6.1 ▼ |
| Thailand | -4.8 | -8.0 ▼ | Fiji | -4.9 | -19.8 ▼ |
| Viet Nam | 4.8 | 1.8 ▼ | Papua New Guinea | 0.8 | -2.9 ▼ |
| Developing Asia | 2.2 | -0.7 ▼ | Excluding NIEs | 2.4 | -0.5 ▼ |

Source: Asian Development Outlook database.

As COVID 19 slows growth in Asia, the global level of PPP transactions has been declining – on a widespread basis. Globally, the primary market transactions have fallen from 2010 to 2019, while in the Asia-Pacific region it dropped from \$46.8billion to \$33.8 during the same period.

The reasons for this are numerous but there is a perception that PPPs are not delivering ‘value for money’ as initially intended and carry too much risk

Mixed Evidence on PPPs VfM

European Court of Auditors (ECA), and the UK's Public Accounts Committee, 2018

The ECA's report, entitled "Public-Private Partnerships in the EU criticized the performance records of PPPs in several EU countries, stating that they were "not always effectively managed and did not provide adequate value-for-money."

European Network on Debt and Development (Eurodad) joint civil society report to the European Parliament "History RePPPeated", 2018

Based on a review of ten projects across the fields of education, energy, health, justice, transport, and water and sanitation, the Report cites a lack of transparency and public accountability to ensure proper contract implementation and improvement of public services.

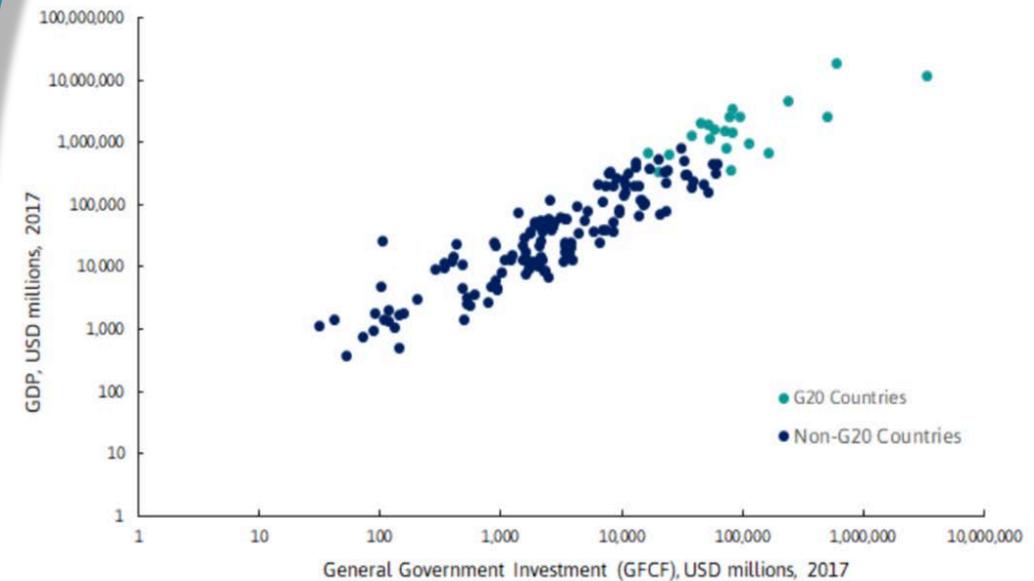
Realizing the Potential of PPPs to Advance Asia's Infrastructure Development, ADB, 2019

"We find evidence that PPPs have positive macroeconomic impacts. This could be attributed to findings in the results that PPPs help improve access to and the quality of infrastructure services. As an extension of the impact of PPPs on economic growth, they could be important tools for poverty eradication efforts in developing Asia."

Public investment including in infrastructure increases GDP more than other types of public spending

- ✓ Infrastructure investment will stimulate growth to recover from the COVID crisis, especially in a low interest rate environment
- ✓ The key is investing in the “right” projects – PPP or not – along the lines of the Quality Infrastructure Investment Principles

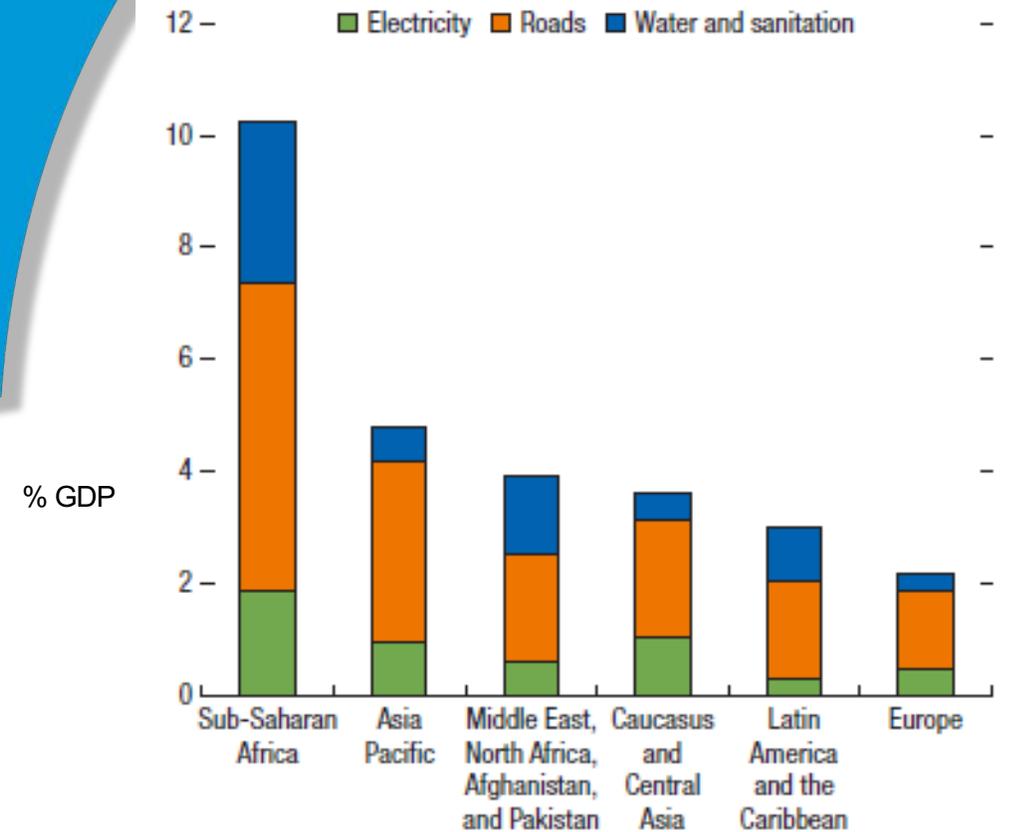
Relationship between GDP and GFCF, 2017



There is a strong positive correlation between GDP and public investment annually and over a long time period.
Source: *Global Infrastructure Hub 2020*

PPP infrastructure investment by the private sector will need to play a role in the recovery

- ✓ Total cumulative investment needs from 2019 to 2030 in the three infrastructure sectors are estimated at around \$12 trillion for 121 emerging market economies and low-income developing countries (36.1 percent of their GDP cumulatively). This implies an annual average investment need of about USD 1 trillion (3 percent of GDP) for these countries¹
- ✓ 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.



¹/Source: Well Spent, How Strong Infrastructure Governance and End Waste in Public Investment, IMF 2020

G-20 Quality Infrastructure Principles

1. Maximizing the positive impact of infrastructure to achieve sustainable growth and development;
2. Raising Economic Efficiency in View of Life-cycle Costs;
3. Integrating Environmental Considerations in Infrastructure Investments;
4. Building Resilience against Natural Disasters and Other Risks;
5. Integrating Social Considerations in Infrastructure Investment;
6. Strengthening Infrastructure Governance

“Quality deserves as much attention as quantity, and progress can be made to further support quality infrastructure in line with the G20 Principles for Quality Infrastructure Investment, which uphold the importance of considering lifecycle costs; sustainability, including debt sustainability and transparency; and resilience and inclusivity in infrastructure investment. Finally, quality infrastructure will be needed even more in the post COVID-19 context to build back better and support green and resilient projects for a sustainable and inclusive recovery...”

Asian Development Fund 13 Donors Report, October 2020

“Support at least 20 countries to identify the governance constraints to the development, financing, and delivery of quality infrastructure investments, with particular attention to project preparation, procurement, environmental and social considerations, and integrity, to inform the adoption of policies and/or regulations for enhanced infrastructure governance ...”

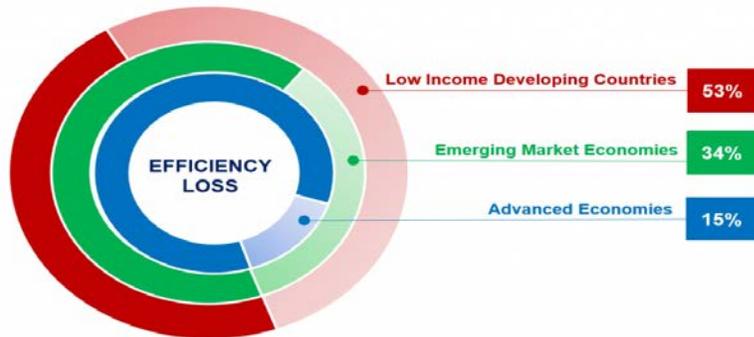
IDA -19 Infrastructure Quality Indicator

The Quality Infrastructure Principles and Value for Money: Why does it matter?

Infrastructure Efficiency Gap in Developing, Emerging and Advanced Economies

Road to nowhere

Countries waste anywhere from 30 up to 50 percent of the money they spend on infrastructure.
(percentage deviation from full efficiency)

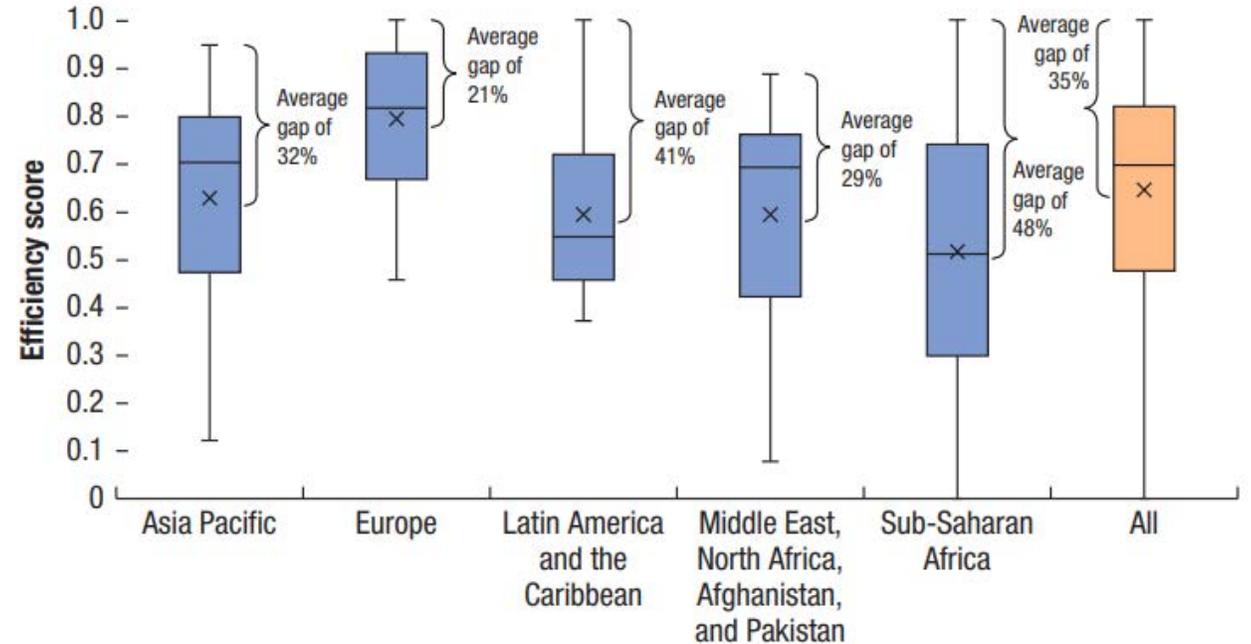


Source: G. Schwartz, M. Fouad, T. Hansen, and G. Verdier, "Well spent, How Strong Infrastructure Governance Can End Waste in Public Investment."

INTERNATIONAL MONETARY FUND

Source: IMF Public Investment Management – Review and Update, 2018

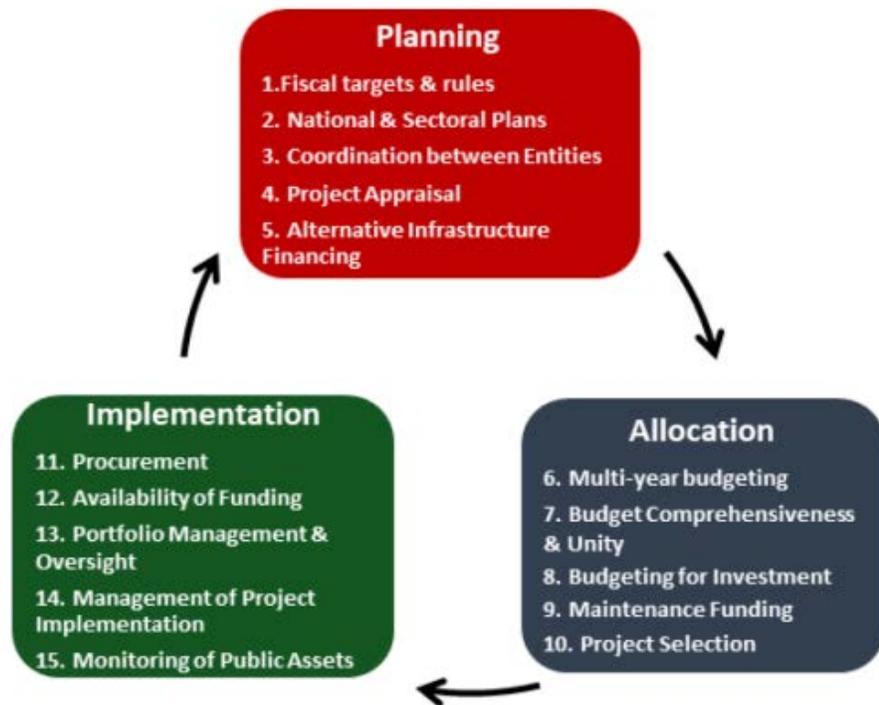
Regional Comparison of Infrastructure Efficiency Gap



Source: Well Spent: How Infrastructure Governance Can End Waste in Public Investment, IMF, 2020

Infrastructure Investment will play a key role in post COVID-19 Recovery. Countries waste about 1/3 of their infrastructure spending due to inefficiencies. The loss can surpass 50 percent in low-income countries. Value for Money Analysis can help unlock this potential as countries recover from the pandemic.

Infrastructure Governance and the PIMA Framework



Source: IMF Public Investment Management – Review and Update, 2018



Source: IMF Public Investment Management Assessment missions, 2015-2019.

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.

Value Drivers of VFM

Value drivers refer to the essential factors that projects need to achieve VFM, maximize social and economic benefits, and manage risks.

- ✓ Risk Transfer
- ✓ Whole-life Costing
- ✓ Budget Certainty and Service Predictability
 - Avoid the “fiscal illusion of PPPs”
- ✓ Focus on Service Delivery
- ✓ Innovation
- ✓ Asset Utilization
- ✓ Accountability
- ✓ Transparency

At the heart of every PPP transaction is the allocation of risks between the public and private partners. Often governments have inability to

- (i) identify,
- (ii) price and
- (iii) manage PPP risks. From a broader economic and fiscal management perspective, this constrains a government’s ability to determine the optimal level of guarantees and other forms of contingent liabilities to be provided. This is a fundamental challenge if we are to collectively address the value for money proposition and the foundations of PPP contracting.

Absolute VfM and Relative VfM

ADB VfM Guidance Note on Procurement (2018)

Defines VfM as *“The effective, efficient, and economic use of resources, which requires an evaluation of relevant costs and benefits along with an assessment of risks, nonprice attributes, and/or total cost of ownership as appropriate”*

World Bank , Achieving VfM in Investment Projects Financed by the World Bank, 2016

Defines VfM as *“..the effective, efficient, and economic use of resources, which requires the evaluation of relevant costs and benefits, along with an assessment of risks, and of non-price attributes and/or life cycle costs, as appropriate. Price alone may not necessarily represent VfM.”*

Absolute value for money tests determine whether a project provides overall value for money for society. It is recommended in both the World Bank and ADB procurement guidance for projects.

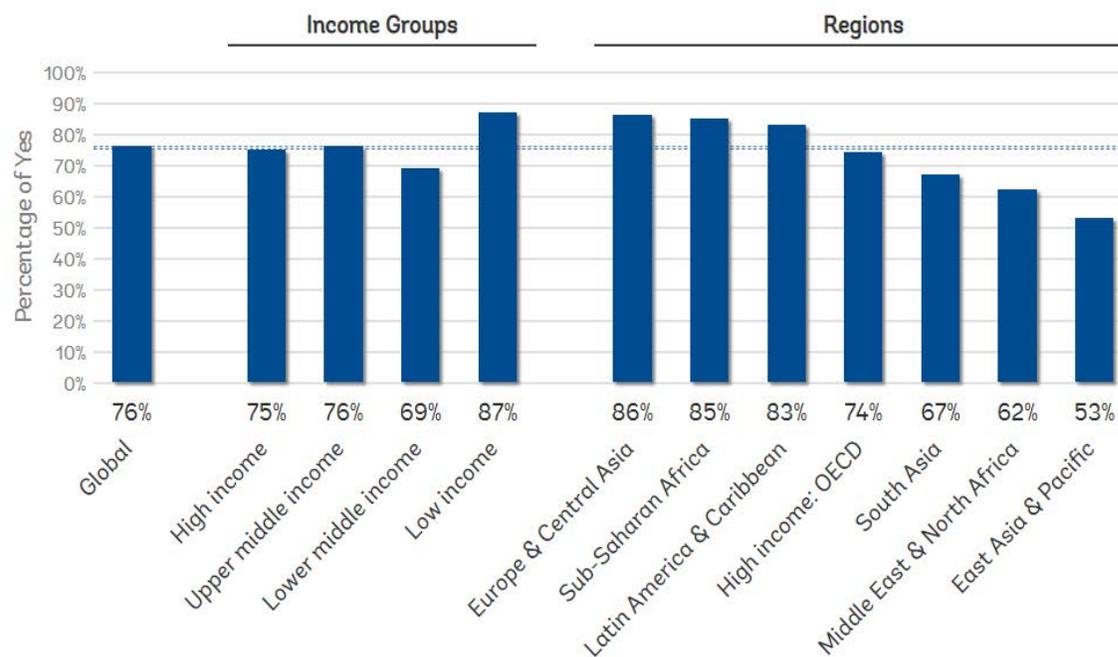
Relative assessments compare different forms of procurement and establish which is most efficient. The assessments judge whether PPPs or traditional infrastructure procurement (TIP) projects are the most efficient form of delivery. This is typically used in PPP projects.

Southeast Asia: PPP Units and Use of Relative VfM

| | Use of public private partnerships | Existence of PPP unit | | | | Use of relative value for money assessments | | Use of absolute value for money assessments | |
|---------------------------------------------------|------------------------------------|-----------------------------------------------------|--------------------------------------------------|----------------|------------------------------------------------------------|---------------------------------------------|----------|---------------------------------------------|--|
| | | Dedicated PPP unit reporting to Ministry of Finance | Dedicated PPP units reporting to line ministries | Other PPP unit | No dedicated PPP unit exists in central/federal government | For PPPs | For PPPs | For TIPs | |
| Brunei Darussalam | ✓ | ✓ | | | | ● | ● | □ | |
| Cambodia | ✓ | ✓ | | | | ● | ● | ● | |
| Indonesia | ✓ | ✓ | | | | ● | ● | ● | |
| Lao PDR | ✓ | | | | ✓ | ● | ● | ● | |
| Malaysia | ✓ | | ✓ | | | ● | ● | ● | |
| Myanmar | ✓ | | | | ✓ | ○ | ○ | ○ | |
| Philippines | ✓ | | ✓ | | | ● | ● | ● | |
| Singapore | ✓ | | | | ✓ | ○ | ○ | ○ | |
| Thailand | ✓ | ✓ | | | | ● | ● | ● | |
| Viet Nam | ✓ | | ✓ | | | ● | ● | ● | |
| SEA Total | 10 | 4 | 2 | 1 | 3 | | | | |
| ● Yes, for all projects | | | | | | 5 | 7 | 7 | |
| ● Yes, for those above certain monetary threshold | | | | | | 2 | 2 | 2 | |
| ○ Yes, ad hoc basis | | | | | | 3 | 1 | 0 | |
| ○ Yes, other | | | | | | 0 | 0 | 0 | |
| □ No | | | | | | 0 | 0 | 1 | |
| Australia | ✓ | | ✓ | | | ● | ● | ● | |
| Japan | ✓ | ✓ | | | | ○ | ● | ● | |
| Korea | ✓ | | | | | | | | |
| New Zealand | ✓ | ✓ | | | | ● | ● | ○ | |
| OECD Total | 26 | 12 | 8 | 2 | 11 | | | | |
| ● Yes, for all projects | | | | | | 9 | 11 | 9 | |
| ● Yes, for those above certain monetary threshold | | | | | | 5 | 4 | 5 | |
| ○ Yes, ad hoc basis | | | | | | 2 | 2 | 1 | |
| ○ Yes, other | | | | | | 5 | 3 | 4 | |
| □ No | | | | | | 5 | 6 | 5 | |
| x Not applicable / survey not answered | | | | | | 0 | 0 | 2 | |

Source: Governments at a Glance Southeast Asia 2019 , ADB and OECD

Comparative assessment (Value for Money analysis)



Source: Benchmarking Infrastructure Procurement, World Bank, 2020

Most countries in the Asia Pacific region have PPP units that carry out both absolute VfM for traditional investment projects and relative VfM for PPPs. Some are required by policy; others may do ad hoc or above certain investment thresholds.

Key Inputs into the Value for Money During Project Appraisal

Feasibility studies carried out during project appraisal provide costs and risk data essential to carry out the value for money assessment

- **Technical**
- **Commercial**
- **Economic**
- **Fiscal**
- **Debt**
- **Environmental & Social and Climate**
- **Legal**

Outputs of Project Appraisal

- Financial Model and technical Requirements
- Tested for affordability and commercial feasibility
- Social-Economic impacts identified
- Value for Money
- Procurement routed decided (Public vs PPP)
- Decision to procure (“green light decision”)

Investment versus Procurement Decision

- ✓ All projects should be subject to selection criteria based on fit with government policy priorities, cost benefit, fiscal and debt constraints, and ability to be funded within the medium-term budget framework. This results an “investment decision”.
- ✓ 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.
- ✓ PPP projects should not be treated differently than other public investment projects that are part of the public investment management plan. The level of scrutiny cannot be less simply because there is a competitive process involving the private sector.



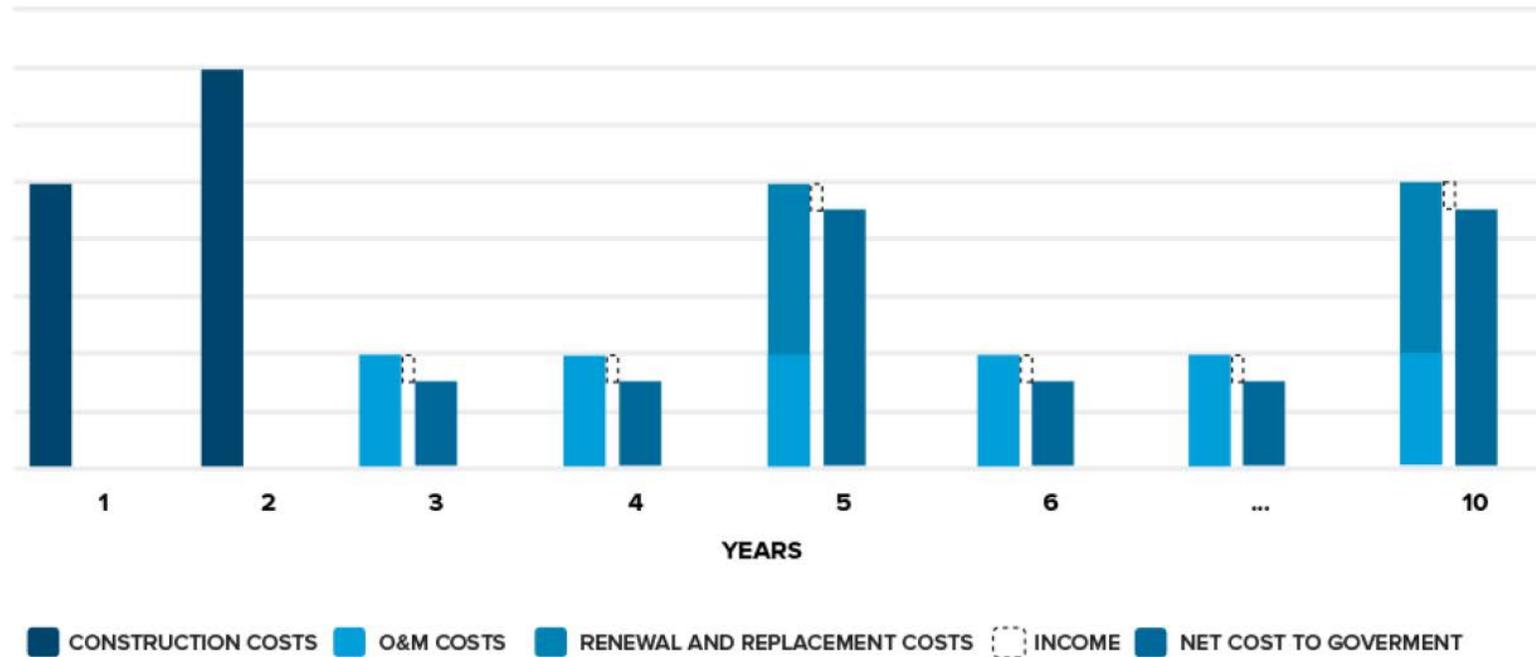
VfM and the Project Cycle

| Phase | Scope (source of data) | Purpose |
|--------------------------|-----------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------|
| Appraisal | VfM using available data. | Indicative for the green light decision. |
| Structuring | VfM may be revisited if necessary (for example, if there has been a material change in the contract structure). | Decision to issue Request for Proposals (RFP). |
| Following contract award | Full VfM, considering final contract after procurement. | Feedback for future projects. |
| Contract management | Full VfM, considering contract amendments and reviewed risk allocation. | Guidelines for conducting negotiation with the private sector. |

Adapted from APMG PPP Certification Guide

Conducting The Public Sector Comparator (PSC)

Net Baseline Project Costs



Life cycle costs of project if done by public sector

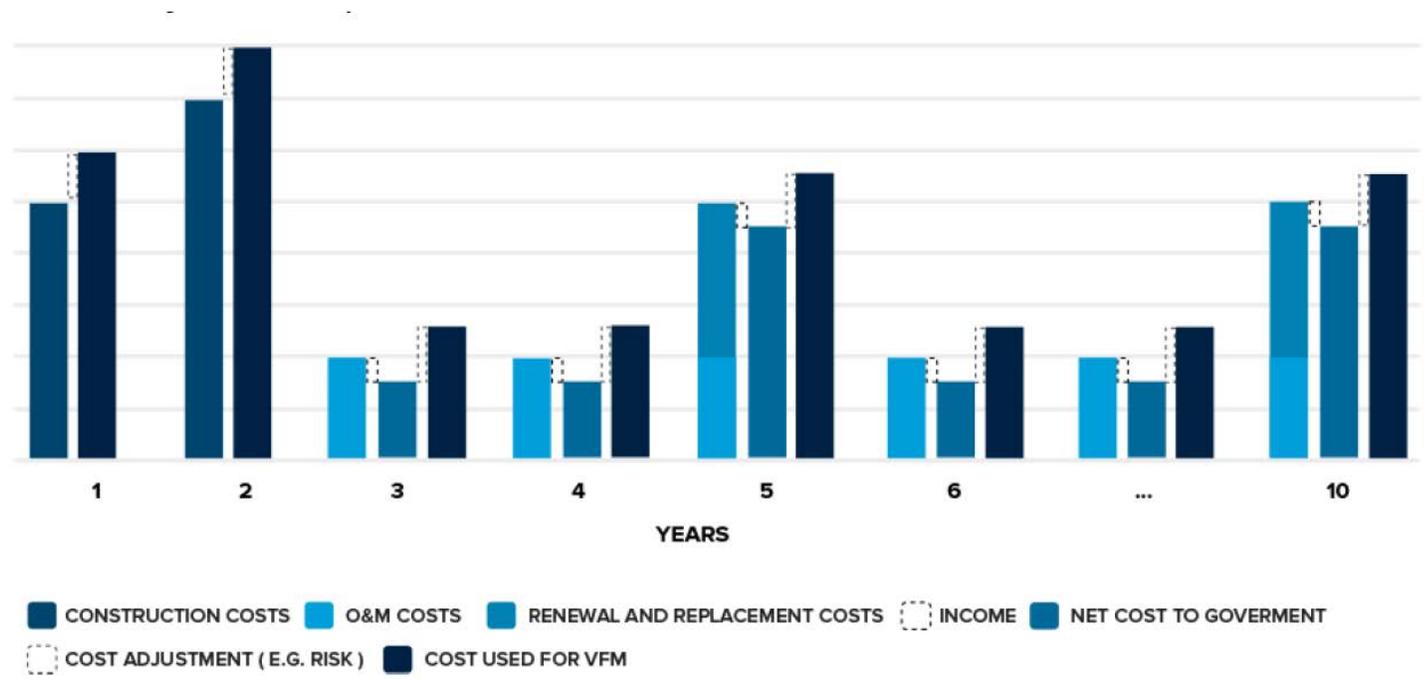
Baseline against which the fiscal costs to government will be measured

PSC reflects the raw net fiscal impact of the project (costs less revenues).

Note: O&M = operation and maintenance.

Turn Raw PSC into an Adjusted PSC for Fair Comparison

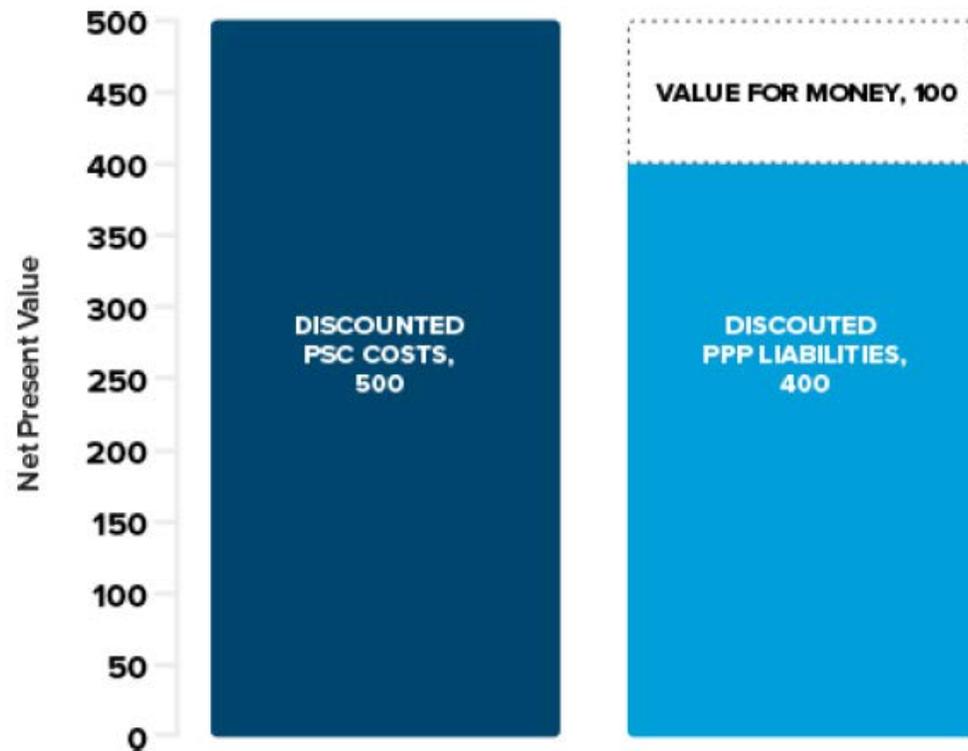
Risk Adjusted PCS Project Costs



Adjusted PSC typically involves adjusting the costs, so they incorporate the risks that the government retains in the traditional procurement such as construction risk and competitive neutrality adjustment

Quantitative VFM Comparing Two Procurement Routes: PPP and Public Option

Simplified Value for Money



Comparison of the Net Present Value of each alternative

The calculation formula can be simplified as follows:

$$VfM = \sum_{t=0}^n \frac{YC_t + ARC_t}{(1+r)^t} - \sum_{t=0}^n \frac{CC_t + OM_t + RR_t + ACO_t + ACN_t + ASE_t}{(1+r)^t}$$

Where:

VfM = Value for Money

YC_t = Yearly cost of the PPP scheme in year t (for instance, availability payments)

ARC_t = Adjustment for regulatory costs

r = Discount rate

CC_t = Construction costs (including overruns) of the PSC in year t

OM_t = Operation and maintenance costs of the PSC in year t

RR_t = Renewal and replacement costs of the PSC in year t

AR_t = Adjustments for risk in year t

ACN_t = Adjustments for competitive neutrality in year t

ASE_t = Adjustments for differences in socio-economic consequences of the project in year t

More of an Art than Science: The need for Qualitative VfM

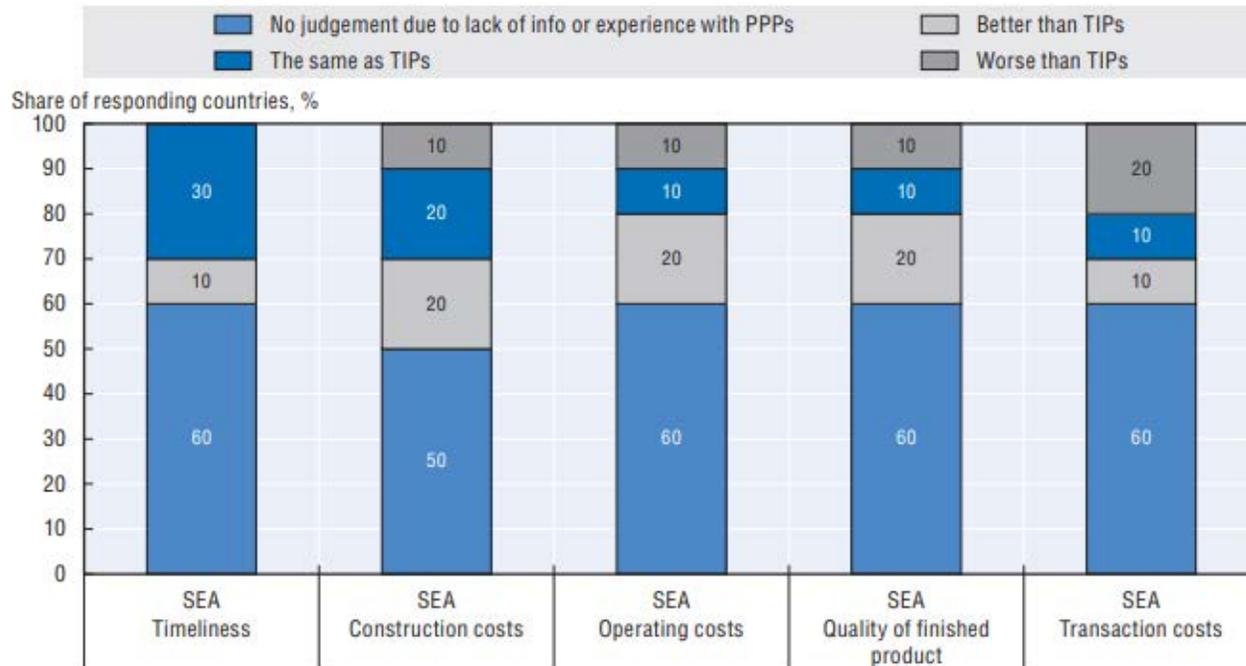
- ✓ There is often a traditional view that suggests that if the EIRR and FIRR meet the critical thresholds this assures VfM of the project. However VfM is more than this.
- ✓ Typically, the quantitative VfM assessment is very much based on unproven assumptions. Not only the valuation of risks and cost estimates, but also the adjustments made to PSC and the discount rate, are estimates with a considerable level of inaccuracy.
- ✓ This is why its conclusions should be read for reference only; they need to be accompanied by sensitivity analysis and the numerical recommendation should always be followed by a qualitative analysis.
- ✓ Qualitative VfM assessment checks whether the general concept of the project fits the model of private sector investment. .

Sample Qualitative Questions

- Are PPPs the best, simplest way to implement this business model?
- Is there much resistance from market players and stakeholders?
- Is there domestic private sector and capital market capacity?
- Is there institutional capacity on the technical side to supervise the contract?
- Is it possible to sign the contract during the current government?
- Does the contract offer accelerated delivery?
- Does it deliver services at a higher standard than government?

What is the evidence that PPPs deliver better Value for Money?

Assessment of PPPs in Southeast Asia



An audit of the UK VfM analysis found that “while the model compared PPP to ‘conventional procurement’, it did not enable the comparison of other contracting approaches with PPP.” The audit also found conventional procurement was ill-defined, and that in some cases, the conventional procurement option was in fact undeliverable.

Source: National Audit Office, (2013), “Review of the VFM assessment process for PFI”, Briefing for the House of Commons Treasury Select Committee

Making PPPs More Effective: A Gateway Process for Fiscal Affordability and VfM

Figure 1. A Generic Gateway Process for Managing PPPs

| Phase in project cycle | | Tasks of the MoF on approval/rejection of projects, including PPPs |
|-------------------------------------------------------|----|----------------------------------------------------------------------------------------------|
| Phase 1: Pre-feasibility | 1 | Assess and give opinion on fiscal affordability of project based on pre-feasibility analysis |
| Phase 2: Feasibility | 2a | Assess and approve fiscal affordability of project based on feasibility study |
| | 2b | Assess and approve fiscal affordability and efficiency of PPP as procurement method |
| Budget | | Facilitate project selection in line with budget envelope and policy priorities |
| Phase 3: Tendering | 3 | Assess and approve fiscal affordability of tendering document (draft contract) |
| Phase 4: Bidding, negotiation and contract signing | 4 | Assess and approve fiscal affordability of final contract |
| Phase 5: Construction and Operation | | Monitor project implementation, fiscal implications – budget and debt |
| | 5 | If contract renegotiation, assess and approve fiscal affordability of changes |

- ✓ The first component of PPP Governance is the gateway process managed by the Finance Ministry. This ensures a quality assurance process at each stage of the PPP project cycle that will ensure fiscal affordability within the government's budget envelope.
- ✓ Even after commencement of operation, renegotiations can change the VfM. The Ministry of Finance should approve renegotiated terms to ensure fiscal affordability and transparency.

Final Thoughts for a Governance Approach to VFM

VfM effectiveness is related to the enabling economic and sector policy environment and institutional framework

- ✓ Rigorous Project Preparation Capacity - Expertise and resources to analyze the economic, social, fiscal, environmental and climate-related costs and benefits over the full cycle of the asset.
- ✓ Risk Assessment and Project Management - Capacity to identify, allocate, and manage risks to maintain VfM throughout the entire project cycle from identification and screening to project implementation.
- ✓ Institutional Framework - Clear allocation of institutional responsibility for decision making and institutional responsibilities for planning, allocating resources, and overseeing implementation



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Restoring Confidence in Public-Private Partnerships

Reforming Risk Allocation and Creating More Collaborative PPPs

Mark Moseley¹

Executive Summary

As part of the work of the Asian Development Bank (ADB) on infrastructure governance, sustainability, and the principles of Quality Infrastructure Investment, this discussion paper has been prepared, at the request of the ADB, to inform ADB staff and officials in ADB developing member countries. It describes the loss of confidence in public-private partnership (PPP) transactions that has led to an ongoing decline in their global use and argues that two of the major contributors to this loss of confidence are the approaches taken in PPP contracts to risk allocation and dispute resolution. The paper examines, in summary form, alternative contractual arrangements—including arrangements employed for transactions that are not PPPs—and analyzes the suitability of their use for PPPs, in the context of the development conditions that are likely to exist following the coronavirus disease (COVID-19) pandemic. Finally, the discussion paper introduces a series of suggested incremental reforms to current PPP contracting practices, incorporating aspects of the various alternative arrangements, and taking into account the associated governance challenges. This brief was financed under the technical assistance for Strengthening Fiscal Governance and Sustainability in Public-Private Partnerships.

1. Introduction: The Necessity of, and the Opportunity for, Public-Private Partnership Reform

At a time when infrastructure PPPs are acutely needed, the global level of PPP transactions is declining—not in every country, but on a widespread basis. The Private Participation in Infrastructure (PPI) database² again reported a

reduction in developing and emerging market PPP investment commitments in 2019—relative to 2018, a trend which began in 2012 (Figure 1). In advanced economies, the United Kingdom (UK) has announced that it will no longer procure national-level infrastructure using the “Private Finance Initiative” approach (a form of PPP developed in the UK),³ and major corporate entities, such as SNC-Lavalin Group Inc. and

For inquiries, comments, and suggestions on this governance brief, please contact Hanif Rahemtulla at +632 8682 6997 or hrahemtulla@adb.org. Governance Thematic Group, SDC, ADB. Previous issues of The Governance Brief can be accessed at <http://www.adb.org/publications/series/governance-briefs>.

¹ Mark Moseley is Principal of Moseley Infrastructure Advisory Services. He is the former COO of the G20 Global Infrastructure Hub and a former Lead Lawyer in the World Bank's Infrastructure Practice Group. His email address is Mark.Moseley@MMMIinfra.com.
² The World Bank. 2019. <https://ppi.worldbank.org/en/ppi> (accessed 22 September 2020).
³ Government of the United Kingdom. 2018. Private Finance Initiative (PFI) and Private Finance 2 (PF2). Budget 2018 Brief. Policy paper. <https://www.gov.uk/government/publications/private-finance-initiative-pfi-and-private-finance-2-pf2-budget-2018-brief>. It should be noted that this policy does not apply to projects carried out by devolved governments, such as in Scotland and Wales.

THANK YOU

