

Public Investment Management for Decades to Come

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PIM for SOE Projects

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Outline

- SOE in this presentation generally means non-financial SOEs
- Topics
 - Importance of SOE investments
 - Basic challenges and opportunities in application of PIM to SOEs
 - Cross-country diversity in use of SOEs
 - Challenges in SOE-government relationship
 - Basic entity types and externalities impact on allocation of PIM functions
 - Institutional arrangements important for government-SOE PIM relationships and diagnosis of PIM for SOEs
 - Diagnostic framework for PIM for SOE and other not-for-profit government entity projects
 - Additional desirable institutional arrangements and indicators for integration of SOEs and other government entities into PIM system
 - Next steps

Importance

- **Importance of investment management** to gain economically efficient production and well managed risks
 - SOEs are infamous for poor rates of return on investment
 - IMF found in a sample of 14 countries (including some emerging economies) from its Public Sector Balance Sheet (PSBS) database that **average rate of return on assets was only 1.9%** over 2010-16
- **Importance of SOEs and SOE investment** in economy.
 - Generally limited data available for public corporations (such as OECD surveys and IMF PSBS database), especially limited for developing and emerging economies, but:
 - Independent Evaluation Group (IEG) Approach paper (2018) reports
 - In OECD countries, SOEs account for 15% of GDP; in transition economies SOEs 20-30% of GDP
 - World Bank estimates that SOEs account globally for 20% of investment and 5% of employment
 - IMF PSBS database (2018) shows fixed assets of non-financial SOEs averaging about 18% of GDP for 15 advanced economies, 24% for BRICS (excl. China), 17% for 10 emerging and 12% for 9 developing economies.
- High variation in use of SOEs across countries (*more later*)

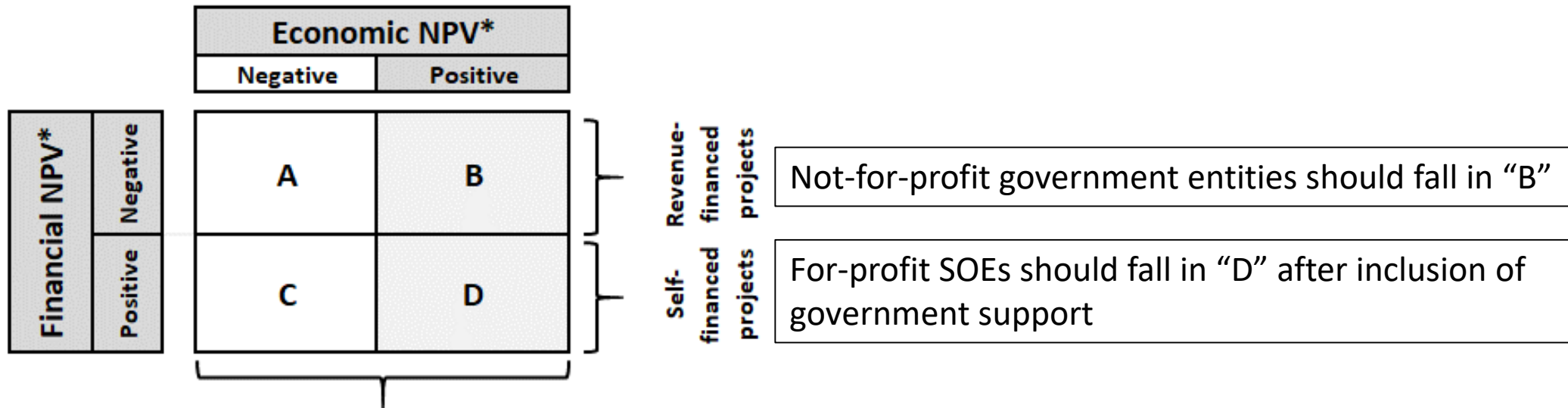
Basic challenges and opportunities (1)

- Application of PIM functions to public corporate entities (market and non-market)
 - PIM diagnostic frameworks well developed for government investments including PPPs, but not specifically extended to SOEs and other government non-market corporations.
 - Public corporations generally operate quasi independently under board of directors and management team – potentially a benefit in achieving performance efficiency and accountability, but challenge of coordination and consistency with broader public policy.
 - Issues of how to ensure 8 core functions of PIM are implemented to achieve planned economic, financial and distributional impacts of SOE investments
 - Which functions can SOE conduct independently?
 - How are goals established, monitored and reviewed?
 - Does a corporate entity use an integrated appraisal framework?
 - How is the performance of the SOE monitored and reviewed?
 - Which functions need external review or direction?
 - In general, how does SOE PIM systems relate and integrate to broader government PIM system?

Basic challenges and opportunities (2)

- Application of **integrated project appraisal** in context of quasi independent public entities basically managing their own financial viability

Components of Integrated Project Appraisal and Viability Matrix



Distribution of net gains (losses) to financiers, government treasury, stakeholders and other affected persons

Risk analysis and mitigation measures (real and financial options, contracts, etc.) are included in appraisals from financial, economic and distributive perspectives

* NPV = Net Present Value = PV of Benefits or Revenues - PV of Costs

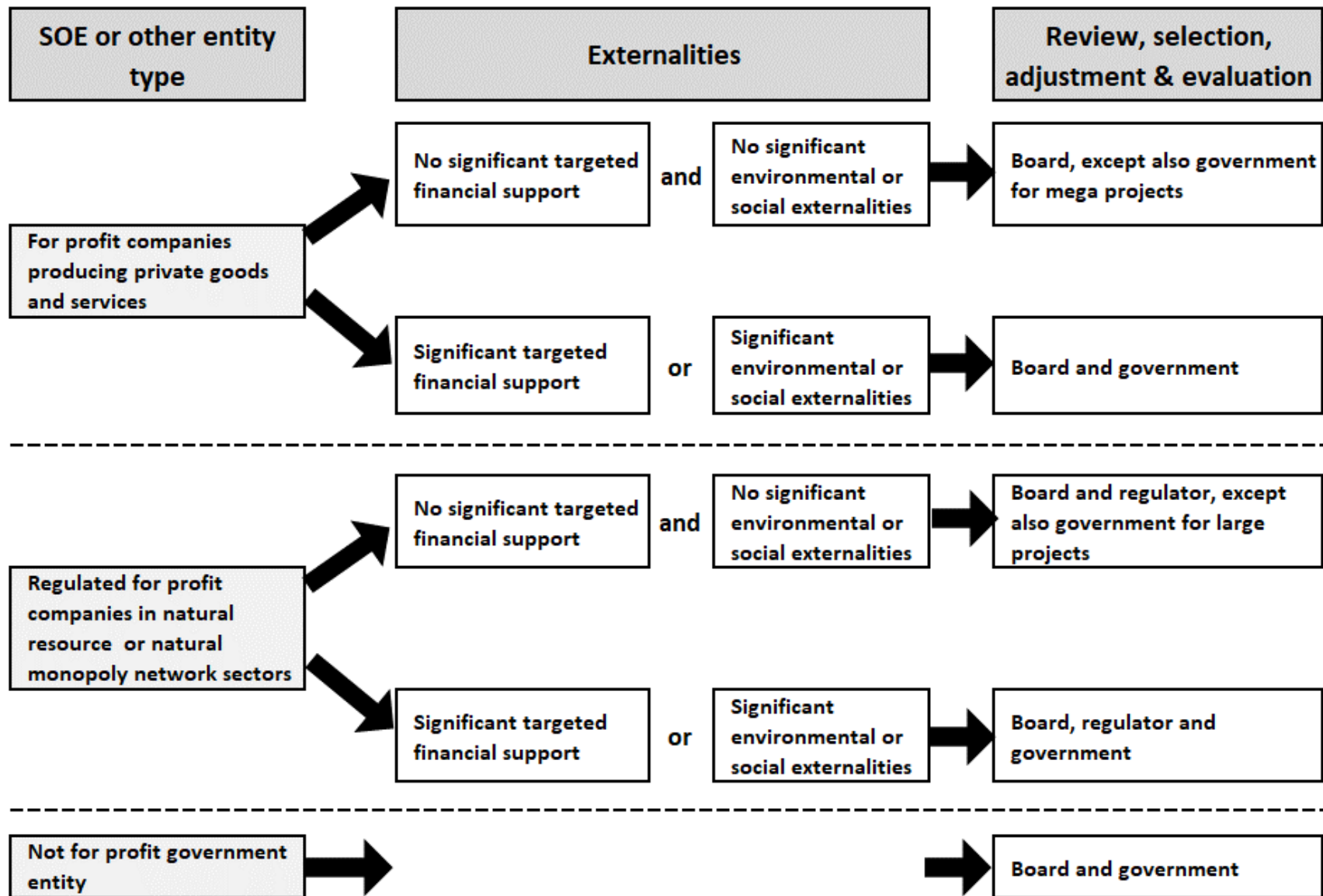
Cross-country diversity in use of SOEs

- **OECD survey of SOEs in 32 OECD and 7 other countries (including Brazil, China and India) for 2015:**
 - **China** is outlier with 157,926 non-financial SOEs, vastly more than 38 other countries in survey combined with only 2,153 non-financial SOEs
 - Only **5 countries have over 100 non-financial SOEs**, namely, Brazil, Czech Republic, Hungary, India and Lithuania (excluding China).
 - **5 countries have less than 10 non-financial SOEs**, namely, Australia, Austria, Japan, Switzerland and the United States.
 - Outside of India and Italy, less than 5% of non-financial SOEs are listed corporations, but listed corporations are larger companies
 - Listed SOEs form 45% of equity value and 25% of employment of all SOEs (including financial SOEs, but excluding China.)
 - Variation in **corporate form** (incorporated under company law or special statutory law):
 - 77% are **majority owned non-listed corporations under company law**, and **11 countries** (Brazil, Germany, Greece, Hungary, Ireland, Israel, Italy, Japan, Korea, Netherlands, Slovenia and Spain) **only use this corporate form**
 - 9 countries (Australia, Canada, Costa Rica, Estonia, Lithuania, New Zealand, Norway, Switzerland and United States) have 50% or more **statutory corporations** amongst SOEs; Canada has all its SOEs formed as statutory corporations.
 - Excluding the financial SOEs, most of the majority-owned **listed corporations** are in **primary, manufacturing, electricity and gas sectors**. Generally, **non-listed non-financial SOEs are more concentrated in the regulated sectors, namely, primary sectors, telecommunications, transportation, electricity and gas and other utilities** as well as “other activities.” These sector distributions are suggestive that **most of the SOEs are in regulated sectors**.
- **IMF PSBS database for 38 countries for 2012-2016**, compared to an average ***fixed assets over GDP*** of about **16%** for non-financial SOEs
 - 9 countries over 20% of GDP (with South Africa highest at 44%)
 - 11 countries below 10% of GDP

Challenges in SOE-government relationship

- **Legal and regulatory framework:** combination of
 - Corporate/company or special statutory law
 - Regulatory laws for natural resource exploitation and natural monopoly network sectors
 - Public financial management (PFM) law
 - SOE specific law
- **Ownership**
 - Direct equity holding
 - Indirect through guaranteed public pension fund
- **Financial risks**
 - Soft Budget Constraint (SBC) and implicit guarantees
 - Explicit guarantees
 - Variations in revenue streams and support obligations
 - Over or under exploitation of SOE rents
- **Financial support**
 - Direct budget
 - Loan guarantees
 - Tax expenditures
 - Procurement preferences
- **Collusion, corruption and competence**
 - Control of ownership opens up options through appointments and directives
 - *Sound legal and regulatory framework is a necessary, but not a sufficient condition for SOE performance*

Basic entity types and externalities impact on allocation of PIM functions



Note: Targeted final support includes direct budget support, on-lending, guarantees, tax expenditures, and procurement preferences

Institutional arrangements important for government-SOE PIM relationships and diagnosis of PIM for SOEs

| Core PIM function | Institutional arrangements important for government-SOE PIM relationship |
|--|--|
| Project preparation phase | |
| 1. Strategic Guidance & Preliminary Screening | 1.1. Sector planning co-ordination 1.2. Entity performance targets for social policy activities |
| 2. Formal Project Appraisal | 2.1. Project appraisal capacity 2.2. PIM manual directing appraisal requirements 2.3. Public sector debt and fiscal risk management capacity |
| 3. Independent Review of Appraisal | 3.1. External project appraisal review capacity and practice 3.2. Inter-ministerial project appraisal review practice |
| 4. Project Budgeting and Selection | 4.1. PIM guidelines for project approval and budgeting channels 4.2. Unbiased competition in selection for supply of regulated products 4.3. Transparency of SOE and other government entity investment plans |
| Project implementation phase | |
| 5. Project Implementation | 5.1. Transparency and competitiveness of project procurement 5.2. Project implementation monitoring and reporting guidelines and practice |
| 6. Project Adjustment | 6.1. Authority to manage and approve project adjustments 6.2. Budget reallocation procedures and practice |
| 7. Facility Operation | 7.1. Service delivery and operating & maintenance reporting requirements and practice |
| 8. Project Evaluation | 8.1. Impact evaluation reporting and practice 8.2. Audit Committee roles 8.3. Ex post project evaluation requirements and practice |

Key role for **PIM manual** in providing detailed road map for conduct of PIM functions for different project and entity types & sizes.

PIM and project appraisal manuals supported by **PFM legislation and regulations.**

Diagnostic framework for PIM for SOE and other not-for-profit government entity projects

- **Diagnostic framework** for SOE and other government entity projects is formed by:
 - Checking for the additional desirable institutional arrangements and their related indicators that cover the relationships between government and SOEs (or other government entity). Indicators can be rated or scaled PEFA-style (A, B, C or D) according to the existence, quality and quality of the desirable institutions.
 - Ideally, diagnostic framework for PIM for SOE projects would be applied in parallel or after applying PEFA-style PIM diagnostic to government investment management

Additional desirable institutional arrangements and indicators for integration of SOEs and other government entities into PIM system

| Core PIM function | Desirable institutional arrangements | Indicators | Related PEFA-PIM indicator | |
|--|--|--|----------------------------|---|
| Project preparation phase | | | Number | Description |
| 1. Strategic Guidance & Preliminary Screening | 1.1 Mechanisms to coordinate sector market analysis between government sector planners and controlled SOEs in regulated sectors and SOEs receiving significant government support | 1.1. SOE planned output performance and investments integrated into government published sector strategic plans | 1 | Sector analysis and planning |
| | 1.2. Performance contracts or explicit targets are provided for social or policy activities required of SOE or other public entity | 1.2. Documented performance contracts or explicit targets for social or policy activities of entity | 2 | Strategic plans and investment guidance, project development and preliminary screening |
| 2. Formal Project Appraisal | 2.1. Existence of project appraisal manual covering integrated approach and related capacity and training | 2.1. Existence and requirement to use a project appraisal manual along with training arrangements and funding to sustain capacity | 3 & 4 | Formal project appraisal procedures and guidelines; and project appraisal capacity |
| | 2.2. Existence of PIM manual ^a that lays out channels for screening and appraising projects based on size, complexity and prior experience; also specifies application to SOEs and other entities. | 2.2. PIM manual ^a specifying appraisal channels and application of integrated appraisal to SOEs and other government entities | 5 | Screening and selection of feasibility studies |
| | 2.3. Unit(s) in government to analyze and screen government on lending and guarantees and more broadly the public sector financial and fiscal risks and sustainability. | 2.3. a. Public sector debt management, loan guarantee and fiscal risk units. b. Existence of full consolidated public sector accounts. | | |
| 3. Independent Review of Appraisal | 3.1.. Existence of external institution (university or research institute) with independent technical capacity in sector analysis and project appraisal to conduct technical reviews of large and complex projects. | 3.1.. Number and share of feasibility or prefeasibility studies of large or complex projects by SOEs in regulated sectors or receiving significant government support subjected to external technical review | 6 | Independent review of appraisal |
| | 3.2. Existence of interministerial committees (finance, planning and sector ministries) for technical review of project feasibility studies | 3.2. Number and share of feasibility studies of large or complex projects by SOEs in regulated sectors or with significant government support subjected to review by interministerial technical committee. | | |
| 4. Project Budgeting and Selection | 4.1. PIM manual ^a and budget procedures should make clear where government approval is required in addition to Board approval. These would include all large projects with significant externalities, significant government support and/or significant social or policy functions. | 4.1.. Government approval process for affected SOE investments and government budgeting of contingent and direct liabilities. Explicit budgeting of all compensation for social or policy services provided by entity and all guarantees and contingent liabilities on government. | 7 | Project selection and budgeting |
| | 4.2 Mechanisms should be mandated to ensure transparent and unbiased competitive selection of companies to provide regulated products or services. | 4.2 Transparent procedures are used to select providers of regulated products or services. | 7 & 15 | Project selection and budgeting and procurement |
| | 4.3. To ensure full transparency, SOE and public entity investment plans and financial accounts should be available to parent ministries, appropriate committees of legislature, and unless security issues are involved, general public. Ideally plans and reports should be posted on website of entity and parent ministry. | 4.3. Digital publication on internet websites of SOE and other entity and parent ministry of all investment plans and financial statements (subject to redaction for national security reasons). | 10 | Comprehensiveness and degree of public and parliamentary access to capital budget information |

Additional desirable institutional arrangements and indicators for integration of SOEs and other government entities into PIM system

(continued)

| Core PIM function | Desirable institutional arrangements | Indicators | Related PEFA-PIM indicator | |
|----------------------------------|---|--|----------------------------|---|
| Project implementation phase | | | Number | Description |
| 5. Project Implementation | 5.1. Transparent and competitive e-procurement rules and procedures should be adopted | 5.1. Existence of transparent and competitive e-procurement rules and procedures of both government and SOEs | 15 | Procurement |
| | 5.2. All SOEs and other public entities should have (i) clear project implementation management procedures, (ii) monitoring and reporting procedures on project implementation physical and financial milestone achievements and (iii) requirements for a completion review and report. | 5.2. Regular (at least quarterly) progress reports and final completion report to parent ministry or regulator agency on all projects that required government approval. | 16, 17 & 18 | Project implementation management; control, monitoring and reporting; physical and financial milestones; and project handover, asset registration and completion review |
| 6. Project Adjustment | 6.1. Transparent allocation of authority and clear procedures for government and/or a regulator to review and approve any major adjustment to any project and its funding that initially required government and/or regulatory approval | 6.1. Documentation of explicit allocations of authority and procedures to manage project adjustments | 19 | Project adjustment |
| | 6.2. Procedures and institutional capacity to handle budget reallocations where adjustments have budget implications for government. | 6.2. Documented procedures and evidence of actual practice of budget reallocations in response to project adjustments | | |
| 7. Facility Operation | 7.1. Regular (at least quarterly) reporting of service delivery, operating and maintenance costs and receipt of budget support (where applicable) by projects requiring initial approval by government and/or regulatory authority | 7.1. Regular reports of service delivery, operating and maintenance costs and receipt of budget support (where applicable) by projects requiring initial approval by government and/or regulatory authority received by these agencies and ministry of finance | 20 | Control, monitoring and reporting; financial and service delivery performance |
| 8. Project Evaluation | 8.1. Where entity has a major social or policy activity output, entity should conduct impact evaluation of service delivery. | 8.1. Impact evaluation reports where a major social or policy related service delivery by entity | 22 & 23 | Scope, nature and follow-up of external audit and ex post evaluation; and legislative scrutiny of external audit reports |
| | 8.2. Timely submission and where appropriate publication of external audit reports to government and legislature audit committee. Effective scrutiny of audit reports by legislature and effective responsiveness by entity to recommendations of legislature. | 8.2. Timely review and recommendations from audit committee on entity external audit reports, and timely responsiveness by entity to recommendations | | |
| | 8.3. For large and complex projects requiring government approval, ex post evaluations should be conducted after about 10 to 15 years from project start. | 8.3. Ex post project evaluation reports of large-scale and complex projects are publicly available. | | |

Next steps

- Expand OECD SOE survey to more emerging and developing economies
- Expand IMF Public Sector Balance Sheet (PSBS) database to more countries and years
- Review PFM legislation across countries and for general application to PIM and for specific application to PIM for SOEs
- Review, test and revise PIM for SOE diagnostic framework
 - Note parallels with SOE governance reforms such as in World Bank, *Corporate Governance of State-Owned Enterprises: A Toolkit*, 2014, but focus on reform of detailed PIM functions
- Conduct in depth case studies of PIM for SOE projects in a range of countries
- Use PIM for SOEs and other not-for-profit government entities diagnostic framework in conjunction with PEFA-style PIM diagnosis to identify gaps in PIM systems and initiate reforms