



“Evaluating performance of public sector projects in Russia: The choice of a social discount rate”

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Received 12 December 2014; received in revised form 16 November 2015; accepted 26 November 2015

Available online 7 January 2016

Abstract

Public sector project management in Russia is inefficiently carried out. One reason for this is an absence of generally accepted procedures for evaluating the performance of projects. In the framework of evaluating performance, there is the issue of evaluating the rate for discounting the anticipated benefits and costs of public projects to the present moment. This paper contains a methodology for estimating the social discount rate for cost–benefit analysis in various economic industries in Russia. We apply two approaches – social rate of time preferences and social opportunity cost of capital – and propose a methodology for projects related to any industry. We present examples of estimating the social discount rate for healthcare, education, social services, and infrastructure projects. Our results are useful when both the government and private firms are able to solve the same social problems. The findings are applicable for any country with unequal development of various economic industries.

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Keywords: Social discount rate; Projects; Public sector; Industry; Russia

JEL classification: H43

1. Introduction

Public sector project management inefficiency is a serious problem for many countries, in particular for post-communist states and developing economies. In those countries, direct government investments and various types of government support for private investments form an essential part of national development programs. Project management in the public sector of economics has the long history of developing and improving methods that enable decision-makers to allocate budget resources in the most effective way possible. New public management (NPM) and public value management (PVM) have followed traditional public management. Approaches to public management have changed from the single performance objective of managing inputs and outputs to multiple objectives such as “service outputs, satisfac-

tion, outcomes, maintaining trust and legitimacy” (Smith, 2004, p. 77). Effective project management in the public sector should improve “the ability to achieve outcomes while providing traceability, transparency, and accountability” (Crawford and Helm, 2009, p. 73). The importance of project management is explained by the need for a guarantee of receiving value from budget expenditures.

Public sector project management differs from its private sector counterpart and hence faces additional challenges. The point to be considered in detail is the issue of providing transparency as one of the key elements of project governance. Government agencies are forced to demonstrate “accountability and transparency while effectively implementing policy and adapting to change” (Crawford and Helm, 2009, p. 73). “Public administration institutions are under pressure by stakeholders for performance and transparency” to make viable investment decisions (Pilkaitė and Chmieliauskas, 2015). For those countries where practices of project management in the public sector are still undergoing a process of formation, more transparency is required in the form

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of clarifying project evaluation procedures and providing clear information to the public.

Plenty of studies are devoted to various aspects of public project management, such as the strengths and weaknesses of the project management process and the governance of public investments. Authors argue that principles of project management, such as transparency, performance management, and efficiency should be broadly introduced at both the state and the local administrative levels (Vrečko, Žnidaršič and Kovač, 2015). Various authors have examined the adoption of project management practices in public organizations (Fitsilis and Chalatsis, 2014), the efficacy of performance management (Poister, Pasha and Edwards, 2013), and the impact of performance management on project success (De Carvalho, Patah and De Souza Bido, 2015). Cross-country and cross-industry comparisons of Argentina, Brazil and Chile enable authors to identify areas that play a key role in project performance. Despite the fact that the authors base their conclusions on the analysis of business units from the abovementioned countries, there is no doubt that the factors they identified are also important for public sector projects. These factors include project complexity, which interferes with project success, and industrial sector, as project risk varies across industries. One more factor that significantly influences project performance is national environment (De Carvalho, Patah and De Souza Bido, 2015).

It is worth noting that public sector project management is becoming more and more popular in developing countries like Pakistan (Kundi and Unab, 2014), Jordan (Abbasi and Al-Mharmah, 2000), Ethiopia (Shiferaw, Klakegg and Haavaldsen, 2012), and Ghana (Ofori, 2014). It is also noteworthy that the public management efficiency problem is of high interest for post-communist countries like Romania (Istrate, Marian and Ferencz, 2014), Latvia (Pūlmanis, 2013), and Kazakhstan (Amagoh, 2011; Monobayeva and Howard, 2015).

The crucial stage of the project management process is performance evaluation, as only viable social projects should be considered for implementation. The evaluation process should “run through the life cycle of a project rather than as a hurdle that needs to be cleared to ensure financial approval” (Irani, 2010). It is important that “governments should have formal and well publicized guidance on the technical aspects of project appraisal” (Dabla-Norris et al., 2012). However, methods and techniques to be applied in the public sector still require further development. Methods of evaluating the performance of private investments cannot be used in the public sector because public sector projects create social benefits that are not traded on the market. Examples of such benefits might include reducing morbidity and mortality from various causes, improving the quality of the environment and others. This problem is solved with the help of cost–benefit analysis, which enables decision-makers to estimate the present value of public sector projects in monetary units.

Implementation of cost–benefit analysis involves the important step of choosing a social discount rate (SDR). The social discount rate makes possible the comparison of social benefits and costs that might arise at different time points as a result of the realization of public projects. The value of this rate has a significant impact on the present value of a project. An

overestimated rate might lead to the rejection of a worthwhile project or shift preferences toward quick-impact projects. Conversely, an underestimated rate might cause acceptance of long-term projects with distant benefits to society or to substitution of private investments by government projects. It is important to note that the market rate is not appropriate for discounting the benefits and costs of public projects. Generally, public projects are carried out in sectors where market failures exist or there is no market for social benefits at all. In addition, social benefits and costs should be evaluated from the perspective of society as a whole and not that of an individual investor. Originally, social discount rate was considered as a parameter that indicated the preferences of society “for present versus future consumption, because investment is simply a means of using resources that could be consumed now in order to increase consumption later” (Schad and John, 2012, p. 129). Researchers and practitioners currently use positive rate for discounting future social effects arising from project implementation, as what is shown by Zhuang et al. (2007). However, the methodology for selecting a particular value of this rate remains nontransparent to many project initiators. Thus, valid arguments are required for the correct choice of SDR.

Empirical papers attempt to provide values of SDR for such countries as the USA (Azar, 2007, 2009; Moore, Boardman and Vining, 2013), Germany (Schad and John, 2012), Italy (Percoco, 2008), Canada (Boardman, Moore and Vining, 2010), India (Kula, 2004), and Latin American countries (Lopez, 2008). Along with various empirical estimates, these papers present comparisons of social discount rates recommended by government authorities in different countries. For instance, a recent paper by Spackman (2013) systematizes federal government discount rates in ten OECD countries. Nonetheless, there is no single view on the choice of an approach to social discount rate evaluation. In addition, only a few studies consider determining the social discount rate in the context of a particular industry in which the government invests money. For instance, Paulden and Claxton (2012, p. 612) determine a social discount rate for health and argue that this rate depends on “growth in the cost-effectiveness threshold and the rate at which the higher authority can save or borrow between periods”. Government authorities in certain countries provide values for projects devoted to different industries. For example, the *Treasury Guidance in New Zealand* (2015) dictates using 5% p.a. for office and accommodation buildings, 7% p.a. for infrastructure, and 9% p.a. for telecommunications, IT, and the knowledge economy. Central guidance in Spain provides values of 6% for transport, 5% for environment, and 4% for water (Spackman, 2013). However, these guidelines do not describe the methodology that makes it possible to calculate the social discount rate for projects devoted to another industry or for another country.

The problem of imbalances in the development of various economic industries is present in many countries, including Russia. Thus, this paper aims to provide a methodology of estimating social discount rates for government projects related to different industries. Our findings can lead to improvements in the performance evaluation of public sector investments through the correct choice of a social discount rate. These

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