

Chasing the Benefit Bus: How Price Doesn't Include all Costs



Chris Lowe, June 2015

Recently I scrutinised each jurisdictions understandings of 'value-for-money' (VFM). What I learnt astonished me and I thought others might be interested to learn of the current state of affairs in this department. I did this comparison and assessment because governments all over the world are struggling to keep pace with funding the infrastructure and services that are needed to improve our productivity and quality of life and I've long suspected that the way government buys might be hindering our endeavours in that regard.

First, in looking at each jurisdictions definitions and processes associated with VFM, it's clear that VFM means different things to different people. Each state government and the federal government has its own definition of VFM. There is no consistency between the jurisdictions at all. What's worse is the Federal Government doesn't even formally define VFM – it only discusses 'achieving VFM' and 'considering VFM'.

Second, there are different definitions within jurisdictions. For instance the Victorian Auditor General has a completely different definition of VFM from the Victorian Government Procurement Board. Why? Shouldn't we be aiming for the same things?

Third, each jurisdiction places different priorities and weightings on the determinants of evaluation.

Fourth, with the exception of Victoria, there is no explicit requirement to consider external costs in VFM evaluations. There is also no explicit requirement to consider the triple bottom-line, that is, environmental, economic and social costs (which for the purpose of this paper I'll just summarise as 'social costs'.) Some definitions amongst the states imply the requirement to consider social costs, but implying something's not good enough as it doesn't necessarily pick up all costs or benefits.

Fifth, all of the definitions amongst the jurisdictions are finance centric. I often wonder if it's well understood that financial costs and economic costs are too very different things.

Sixth, when decisions are made in respect of major market transactions, it's impossible to get all the information relating to the decision making and evaluation process. We have to rely on the word of government. And, governments aren't obligated to adhere to some disclosure regimes. Unfortunately many of these documents are just guidelines. And guidelines are just guidelines. Exercising discretion with disclosing an evaluation doesn't instil the public with confidence. For example, Clause 21 of the Transport Integration Act (TIA) (2010) says 'the principle of transparency means members of the public should have access to reliable and relevant information in appropriate forms to facilitate a good understanding of transport issues and the process by which decisions in relation to the transport system are made.' In 2012, I asked for a copy of the triple bottom-line assessments pursuant to the TIA associated with the governments appointment of an operator to 30% of Melbourne's route bus network and got nothing in return. This is just one example of a disclosure regime which is not transparent; rather, it's more opaque.

Lastly, there appears an absence of whole-of-government in procurement and VFM considerations for major market transactions. In other words, the silos of government are alive and well. I'll elaborate on this later.

So some might say - so what? So long as government can show the taxpayer is getting the best possible price, they should be happy. Right?

Wrong. I suggest the 'lowest price mentality' is holding us back as a nation. I suggest this is denying or deferring us benefit. We're always chasing the benefit bus! I suggest this sees us make short term decisions when we need to be making long term decisions. I suggest the focus is wrong. We must stop focusing our procurement endeavours on lowest price and focus our procurement endeavours for major market transactions on societal benefit.

So what can we do about it? Well I believe there are 3 things that might see us better placed. For a start, we need a national and consistent definition and therefore understanding of VFM. We can put a man on the moon, we can agree on a national definition of VFM! This should help us immensely. It will see us aim for societal outcomes, not financial performance improvement. It will also see governments have common goals. So how can we do this?

Second, we should obligate governments to consider triple bottom line imperatives: that is, social, environmental and economic imperatives, and externalities when evaluating major market transactions. And bus contracts are worth hundreds of millions of dollars a year in most states, so they can be considered major market transactions. We can't just keep considering financial imperatives as the sole determinant.

This quote from Larry Berglund says it all.

'...our bid laws create ... a value system which rewards budget savings from one government pocket but does not recognise that it may be offset by a similar expense from another government pocket in the form of an externality cost.' (Berglund, 2011)

Externalities (or spillovers as they're often called) are very powerful, but they're overlooked and rarely valued. As you know, in all transactions, there's a buyer and a seller, but they're not the only people involved in a transaction. Externalities are third parties that did not choose to incur a cost or benefit and are indirectly implicated with the transaction. There are 3 different types of externalities: economic, social and environmental and these are displayed in Figure 1. If externalities were valued as part of the evaluation process associated with major market transactions, I suggest we'd be making some different decisions with regard to who gets a bus-service contract.

I've measured one externality that lives in the blue box of the following Figure, the social box – community prosperity.

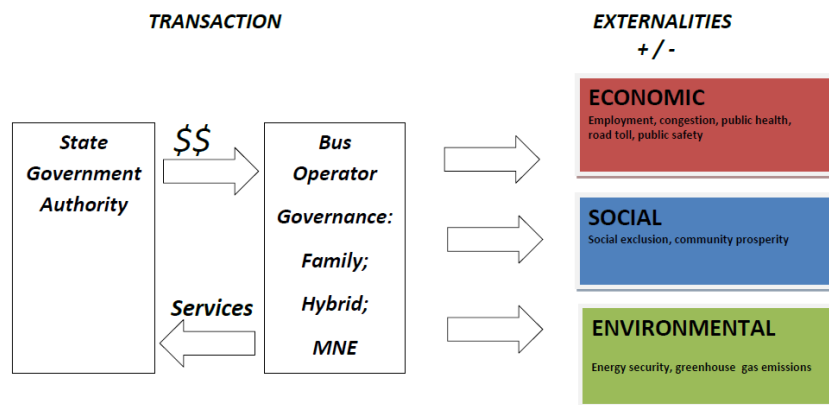


Figure 1: Externalities of Bus-Service Procurement

In 2013/14, I surveyed operators and asked them a whole heap of questions about how they interact with their communities and how their behaviour might change if their bus-service contract margin was reduced. Figure 2 presents this scenario graphically.

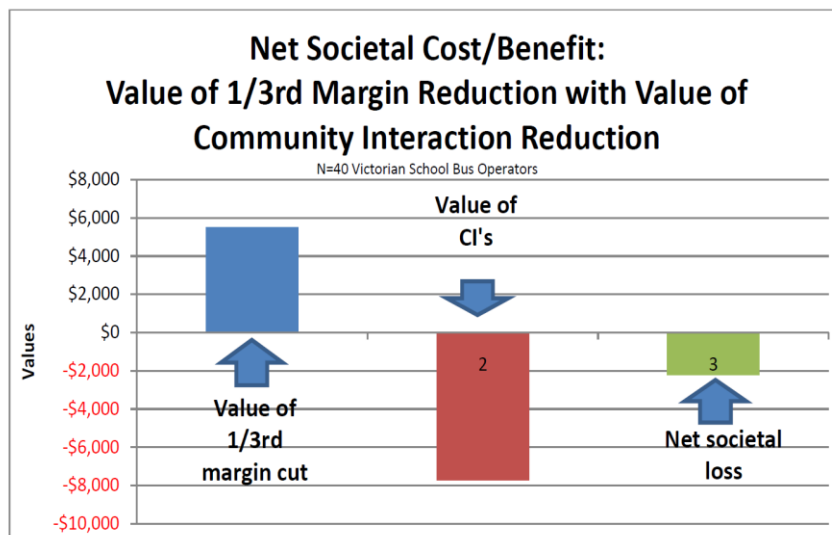


Figure 2: Net Benefit/Cost Associated with 40 Victorian School Bus Operators Margin Reduction and Reduction in Community Interactions

If we looked at this situation in the normal way, if government decided to give all current school bus contracts another 10 years on the condition that everyone's margin gets a cut, well the blue bar is the private saving government would realise. Great for government. This graph is pursuant to Victoria but I could do one for anywhere if the sample size was adequate, the government would save about \$5K a contract. The red bar is the value of the community prosperity externality. This is the part which no-one values - what isn't quantified as part of VFM evaluation methods. The red bar shows how operators would change the level of their community interaction if their contract margin was cut, or how much the operator won't reinvest in the communities in which they operate a bus service as a result of a contract margin reduction. And then the green bar is the value of the net societal, or social loss that would be incurred. This shows that the value of the community interactions foregone exceed the value of the private savings realised by government. It's a win/lose/lose situation. Government saves money, but operators go backwards and most importantly, the community goes backwards. This just reduces the propensity of the operator to spend in their communities, negatively impacting suppliers like fuel and parts. This reduces these businesses ability to employ, and the negative knock on effects just keep coming. Overall, this affects the viability of our towns and runs directly counter to government initiatives on community and regional development.

Our rural towns are dying, our cities are full and if we are going to alleviate this issue, I'm of the view we need to have a greater appreciation for local value. And we do that by taking a whole-of-government, societal level approach to considering VFM, not a lowest price approach.

I believe it's powerful stuff. Of course my work just focuses on one externality - community prosperity, but you can imagine what the social costs would be if we valued externalities such as congestion, or public health. For instance, did you know that PT users get more passive exercise than those who don't and it's possible to value the savings the Department of Health would realise in less presentations to hospital emergency departments and less dependence on the public health system if more motorists got out of their car and onto the bus or the tram or the train - or all 3. Public health savings associated with modal shift from private to public transport is an externality that can be valued.

Here's another example. I recently was asked about funding the state government's Homesafe policy, a policy that will see bus services leave Southern Cross station at 2am and take people back to Geelong, Bendigo, Ballarat and Latrobe Valley. Great policy. I suggested the government quantifies the benefits or savings associated with less road fatalities and funds Homesafe with the savings. A lot of road fatalities occur between 2am and 5am and if more people are going to catch the bus, rather than drive home, there must be road toll savings which will to an extent ease the burden on the health and emergency services systems. The group I was talking to hadn't considered the concept, and it just seemed a bridge too far to try and quantify.

What I'm trying to say is that there's no point one arm of government - let's say the Dept of Transport - saving money in one box, if it just causes another arm of government - let's say the Dept of Regional Development, or the Dept of Health, to incur all these new costs which have a greater value than the savings.

That's why we need to find new and better ways to really have whole of government procurement, and achieve a societal level or socially efficient VFM outcome, not a lowest price VFM outcome. Valuing externalities will greatly contribute toward achieving socially efficient procurement.

Thirdly, whatever decisions are made about procurement, they must be disclosed to ensure transparency. There's no credibility in a government coming out saying 'we just saved the taxpayer \$33m per year as a result of this major market transaction' when it might just be that they've caused one or some other disciplines to incur costs greater than that. Non disclosure of the methodology and evaluation associated with how governments spend tax payers money doesn't instil the public with confidence in government. It instils distrust – and there may be political points to be won if transparency was a genuine requirement.

So HOW do we do all this? Well that's the \$64,000 question.

First, we need to acknowledge we've a problem. Some in government don't think we have a problem. Our procurement regimes are not socially efficient and we need to work with government to make them so. We've got to understand how things in the social realm affect the economic realm. I'm of the view that if we want to fix the economy, let's not focus on the finances. Let's focus on the social realm. I think if we get the social right, the economic bounty will come. This is currently underappreciated as a means of increasing our quality of life.

Second, both Government and Industry must be prepared to change. On the government side, it can't continue to think in silos. It has to instill better whole-of-government practices and implement genuine consultation with other departments and stakeholders - and it starts with one agency or department asking another agency or department the question, how will your discipline be affected if we change this? For example, transport could ask health, how many less road fatalities and costs would we save if we implemented an overnight public transport system? I also believe Industry can help Governments with this understanding what impact in terms of costs or benefits any measure would have on other disciplines.

Thirdly, it will require more education and training of public sector officials. Valuing externalities is not rocket science. But it should be done, because we're talking about our wellbeing. We're talking about our quality of life. If we can do these 3 things, I think our communities, indeed our nation, would be more prosperous.