From Gaps to Solutions:

The Intergovernmental Dimension of Public Investment Management

Jonas Frank
SDC

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Outline

I. Motivation
II. Understanding responsibilities: three layers
III. Challenges
IV. What explains inefficiencies?
V. From gaps to solutions

I. MOTIVATION: THERE ARE WIDENING GAPS BUT RESPONSIBILITIES FOR ADDRESSING THEM ARE ON DIFFERENT LEVELS

Public Investment – its current salience
Everybody talks about Infrastructure…

"We wish to use our oil revenues to invest in infrastructure which can benefit future generations"

Mrs Kiwanuka, Minister for Finance, Planning and Economic Development of Uganda

" What we need are viable, bankable and innovative projects which provide added value for investment and modernizing the economy"

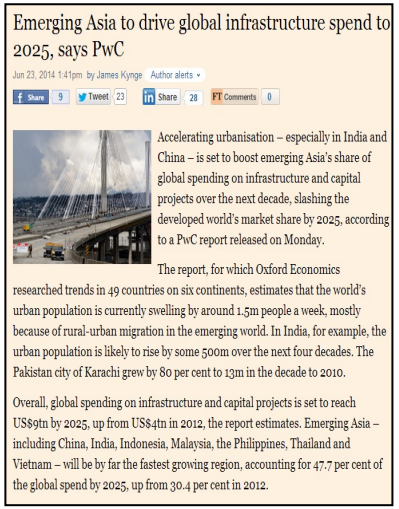
Werner Hoyer, EIB, November 2014

"Time is right for an infrastructure push in countries where conditions are right"

IMF, World Economic Outlook, October 2014

Growing support for Asia Infrastructure Investment Bank

G-20 focus on infrastructure investment



Emerging Asia to drive global infrastructure spend to 2025, says PwC

Jun 23, 2014 1:41pm by James Kynge Author alerts

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Accelerating urbanisation – especially in India and China – is set to boost emerging Asia's share of global spending on infrastructure and capital projects over the next decade, slashing the developed world's market share by 2025, according to a PwC report released on Monday.

The report, for which Oxford Economics researched trends in 49 countries on six continents, estimates that the world's urban population is currently swelling by around 1.5m people a week, mostly because of rural-urban migration in the emerging world. In India, for example, the urban population is likely to rise by some 500m over the next four decades. The Pakistan city of Karachi grew by 80 per cent to 13m in the decade to 2010.

Overall, global spending on infrastructure and capital projects is set to reach US$9tn by 2025, up from US$4tn in 2012, the report estimates. Emerging Asia – including China, India, Indonesia, Malaysia, the Philippines, Thailand and Vietnam – will be by far the fastest growing region, accounting for 47.7 per cent of the global spend by 2025, up from 30.4 per cent in 2012.

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October 6, 2014 2:12 pm

Why public investment really is a free lunch

By Lawrence Summers

The IMF finds that a dollar of spending increases output by nearly $3

It has been joked that the letters IMF stand for "it's mostly fiscal". The International Monetary Fund has long been a stalwart advocate of austerity as the route out of financial crisis, and every year it chastises dozens of countries for their fiscal indiscipline. Fiscal consolidation – a euphemism for cuts to government spending – is a staple of the fund's rescue programmes. A year ago the IMF was suggesting that the US had a fiscal gap of as much as 10 per cent of gross domestic product.

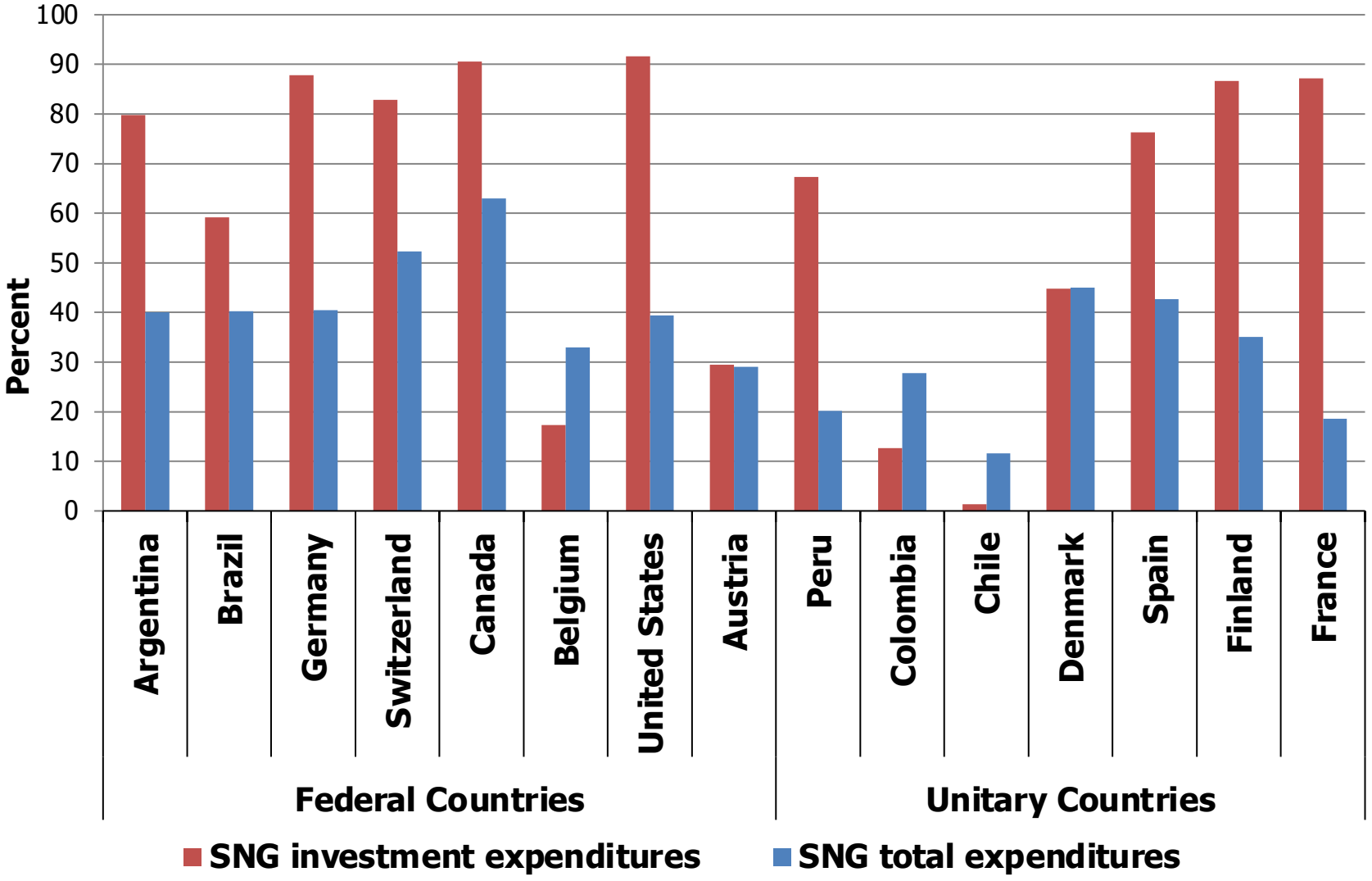
The FT's A-List

The A list

The A-List provides timely, insightful comment on the topics that matter, from globally renowned leaders, policy makers and commentators

All of this makes the IMF's recently published World Economic Outlook a remarkable and important document. In its flagship publication, the IMF advocates substantially increased public infrastructure investment, and not just in the US but much of the world. It asserts that when unemployment is high, as it is in much of the industrialised world, the stimulative impact will be greater if investment is paid for by borrowing, rather than cutting other spending or raising taxes. Most notably, the IMF asserts that properly designed infrastructure investment will reduce rather than increase government debt burdens. Public infrastructure investments can pay for themselves.

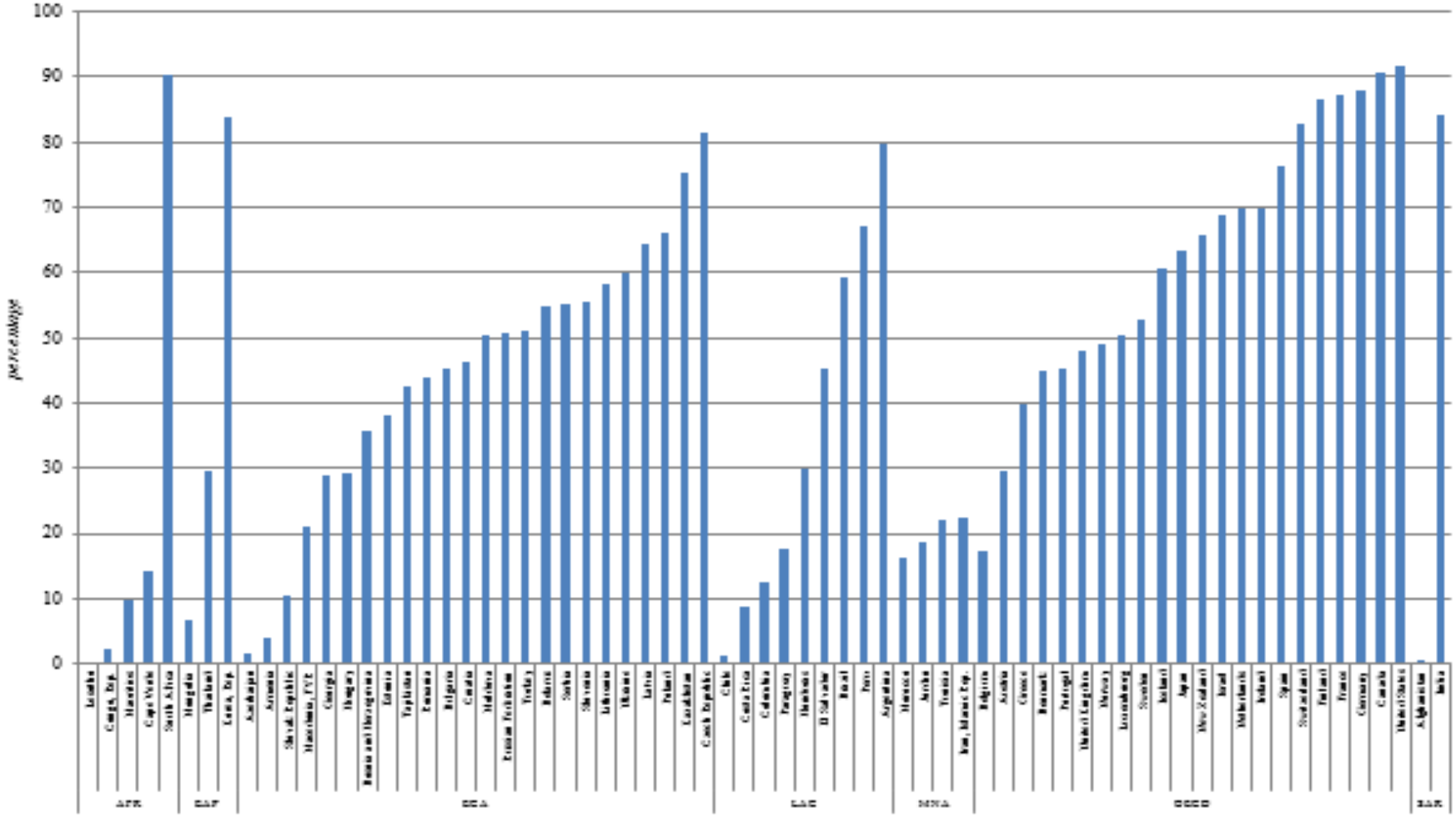
….but few about which level of government is actually responsible and the consequences



Data: 2011. *Source:* GFS and World Bank Fiscal Decentralization Indicators.

A look across the world

Share of Subnational Investment Expenditures



Data: 2011. *Source:* GFS and World Bank Fiscal Decentralization Indicators.

Infrastructure Gaps around the World

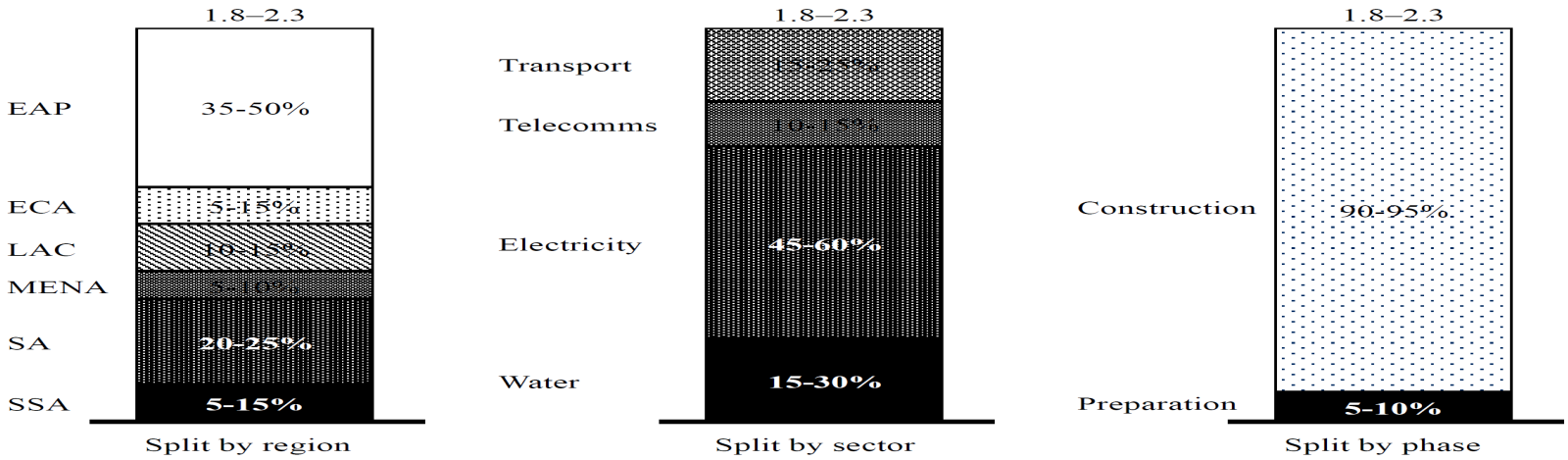
	Avg GDP Growth (2000-2011)[13]	Urbanization Rate (2011)	Telecom Access (per 100 people) (2011)[2]	Electricity Access (% of pop.) (2009)[8]	Access to Improved Sanitation (% of pop.) (2010)*	Access to Improved Water (% of pop.) (2010)[6]
EAP	8.9	49	105	91	66	90
ECA	5.1	65	157	100	84	96
LAC	3.6	79	125	93	79	94
MNA	4.3	59	105	90	88	89
SAR	6.7	31	72	62	38	90
SSA	4.6	36	54	31	31	61
World	2.7	52	103	79	63	88

Source: Andres, Biller, and Herrera Dappe (2013).

“Vertical” gaps: supply vs. demand

- **Developing countries:** spend about USD1 tril. a year on infrastructure, but an additional USD1 tril./yr is required through 2020.
- **Asia and Pacific:** ca. USD 180 billion annually (demand vs. supply; public and private; UN ESCAP 2006)
  - Multilateral financing only represents a small fraction (about 5 percent) of the gap
- **Africa:** USD 93 billion a year (about 15 percent of the region’s GDP; Foster & Briceno-Garmendia)
  - Two-thirds: capital expenditure; One-third: operation and maintenance

Annual infrastructure spending requirements in the developing world ($tr, 2008)



NOTES: $ trillion per year, (2008 real prices), capital investments only (excl. operation and maintenance costs)
SOURCE: Estimated annual infrastructure spending need for 2020 calculated by taking the Fay et al (2010) estimate of $1.25-1.5 trillion annually in 2013 and assuming a 4% annual growth rate from 2013-20, and an additional $200-300 billion annual requirement to make the infrastructure sustainable (both mitigation and adaptation); the split by region, sector, and phase are authors’ own calculations taking ranges from Yepes (2008), MDB G20 working group on infrastructure (2011), and Foster and Briceño-Garmendia (2010); note the $200-300 billion annual requirement for sustainability is assumed split in the same ratio as the other investments across regions, sectors and phases

Urban-rural dynamics

Rural areas

29.4% of rural population is poor

76% of the extreme poor live in rural areas

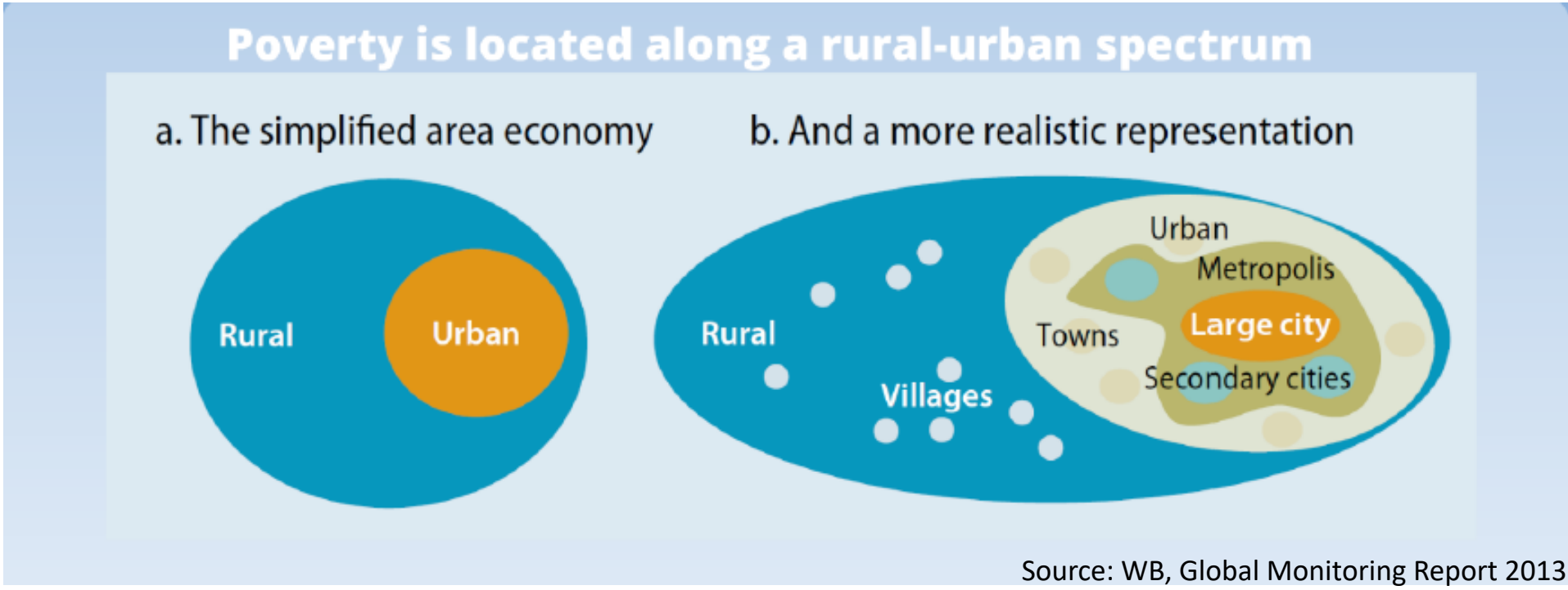
Urban areas

11.6% of urban population is poor

80% of Global GDP

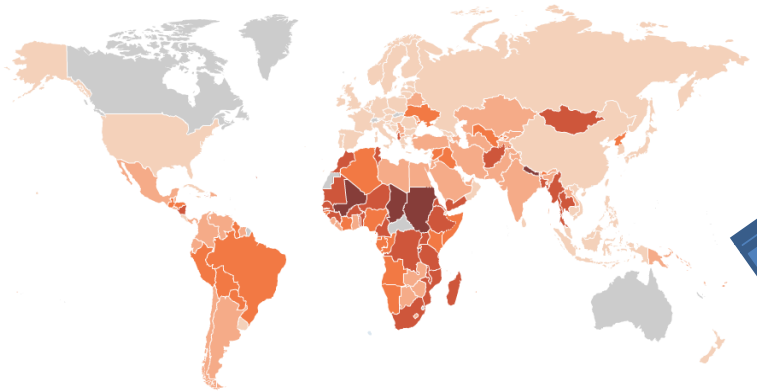
3.6 Billion people in 2010

96% of the additional 1.4 billion people in developing countries between now and 2030 will live in urban areas



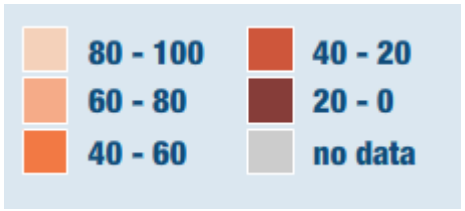
Source: WB, Global Monitoring Report 2013

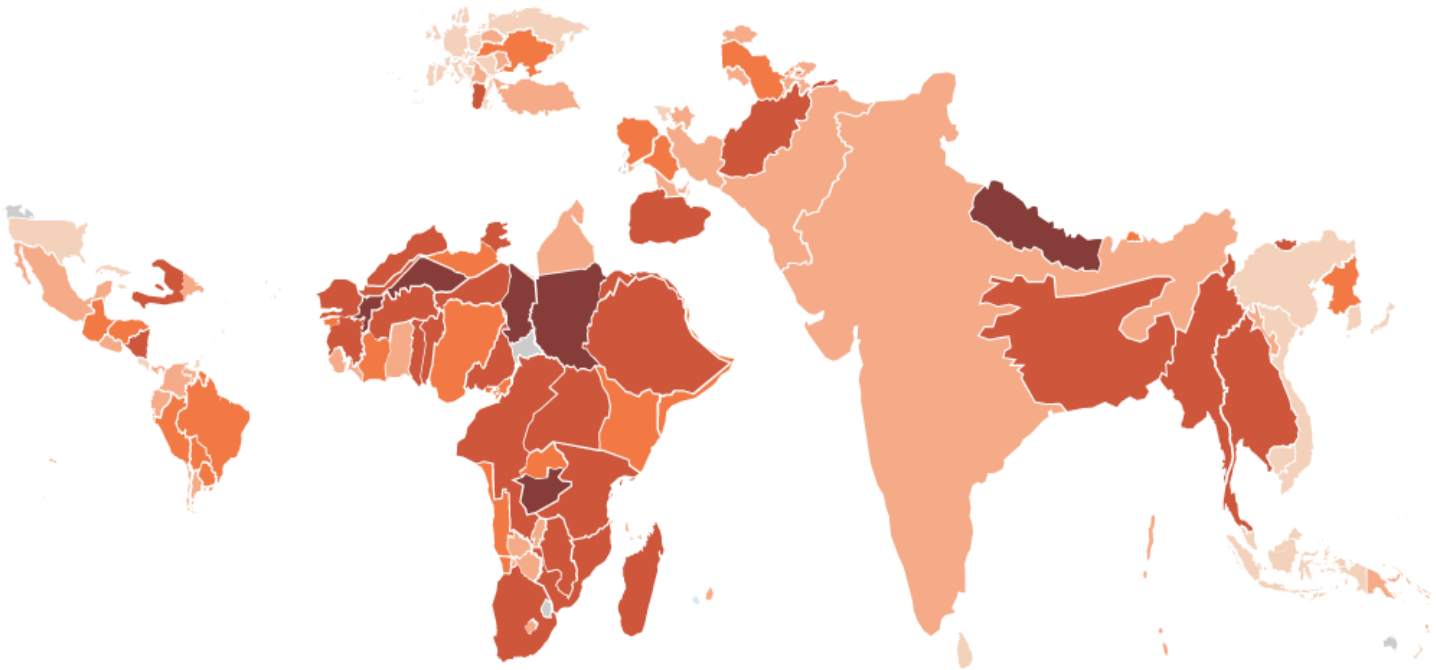
"Horizontal gaps": Rural Access



Total area: 1 billion people

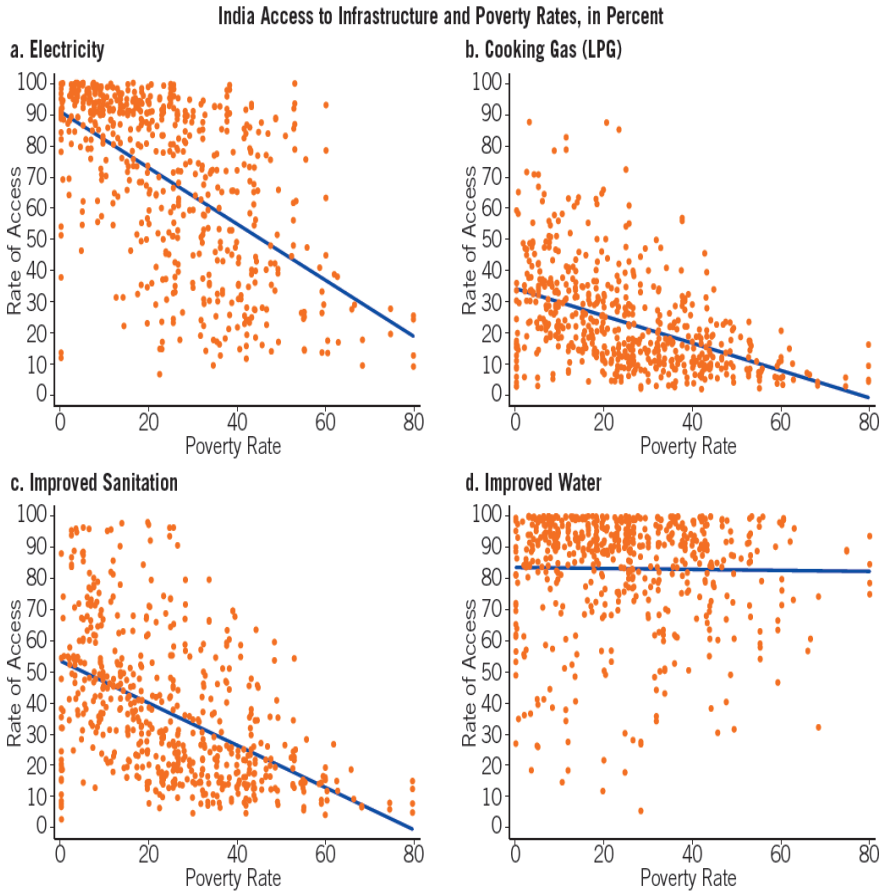
The Rural Access Index measures the number of rural people who live within two kilometers of an all-season road as a proportion of the total rural population

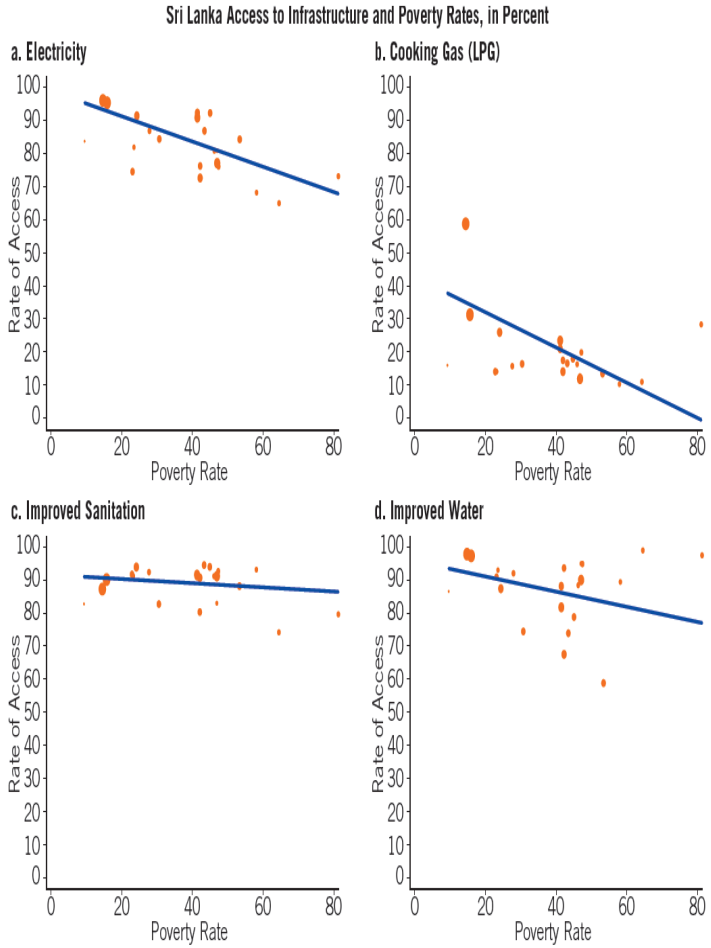




Source: World Bank 2007

Regressivity of Infrastructure Access:
Comparing India and Sri Lanka

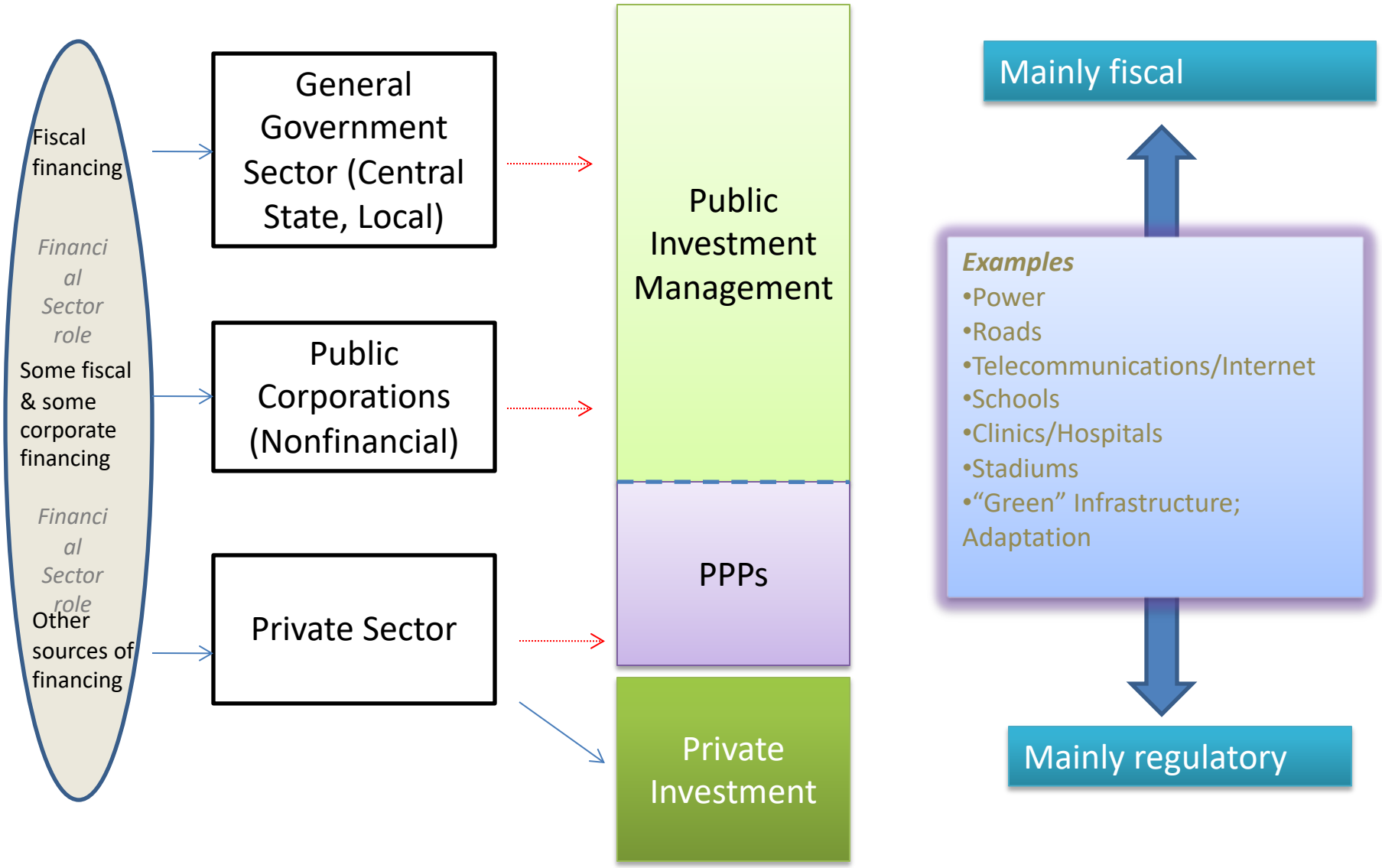




Source: Andres, Biller, and Herrera Dappe (2013).

II. UNDERSTANDING RESPONSIBILITIES: THE THREE LAYERS

A complex multi-actor process



The intergovernmental dimension: three layers of responsibilities

«End services»	**Network infrastructure:** Roads, water,.. **Point infrastructure:** Hospitals, schools…
Project cycle	
Regulation	**Market structure, access regimes, and pricing** **Standard setting:** end-services and project cycle

Organizational approaches at national and subnational levels

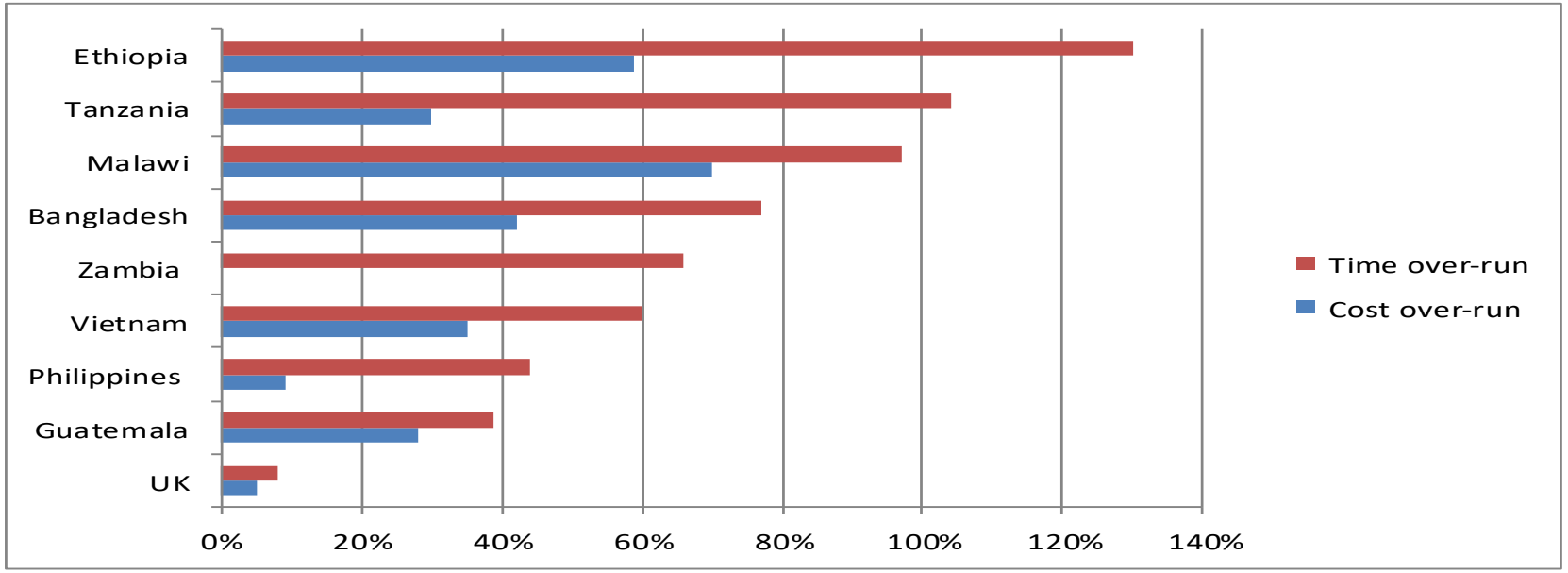
- Sector agency
- Center of government: Ministries of Finance/Planning
- Community management

III. CHALLENGES

Progress is not assured

Source: Based on data from World Economic Forum (2006 and 2010) and IMF-WEO (2002-2010).

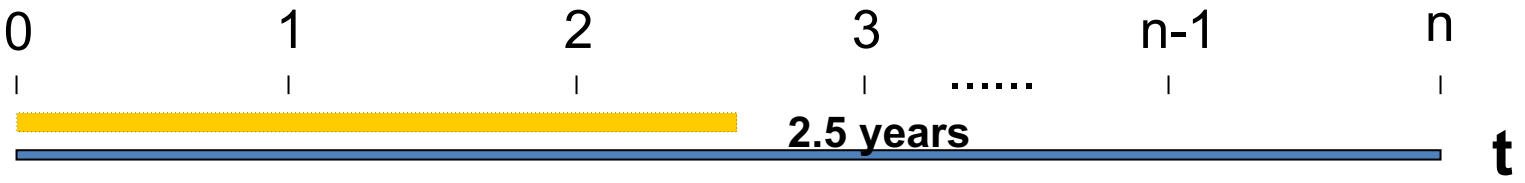
Cost and time overruns



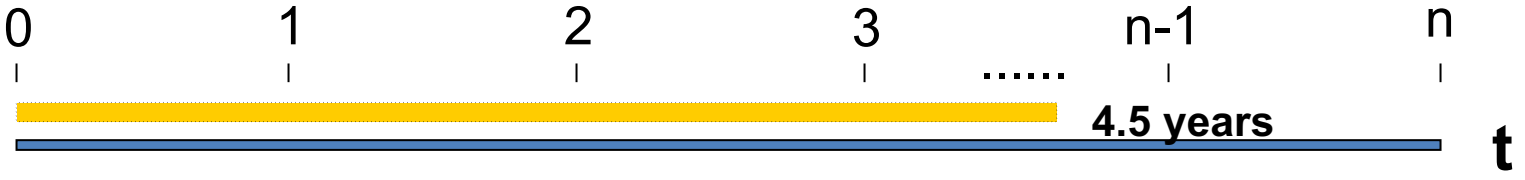
Source: CoST (2011), IMED for Bangladesh

Peru: sample of regions (*departamentos*)

Average time estimated at pre-investment stage



Average time for executed investments

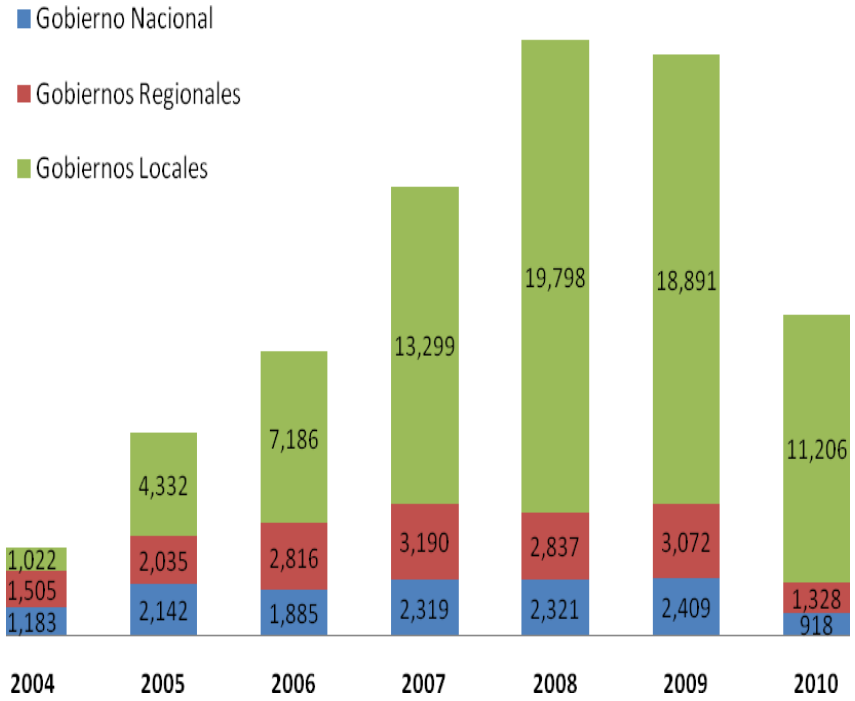


Source:
WB estimates

Fragmentation combined with limited checks and balances

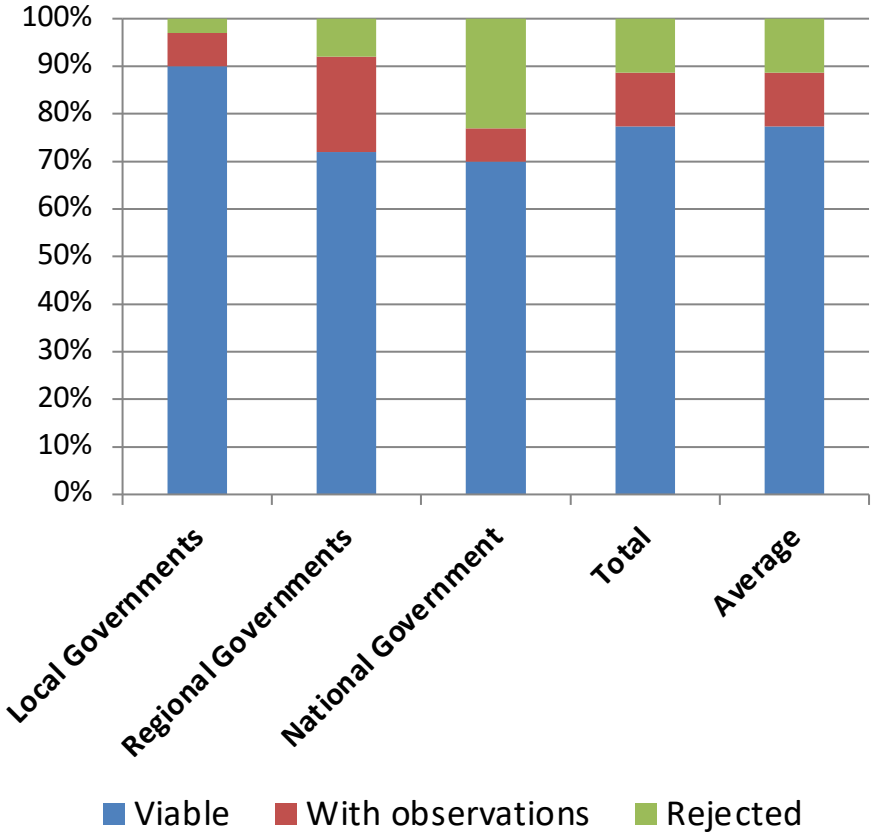
Example of Peru

Number of viable projects (pre-investment)



Green: municipalities
Red: regional governments
Blue: national government

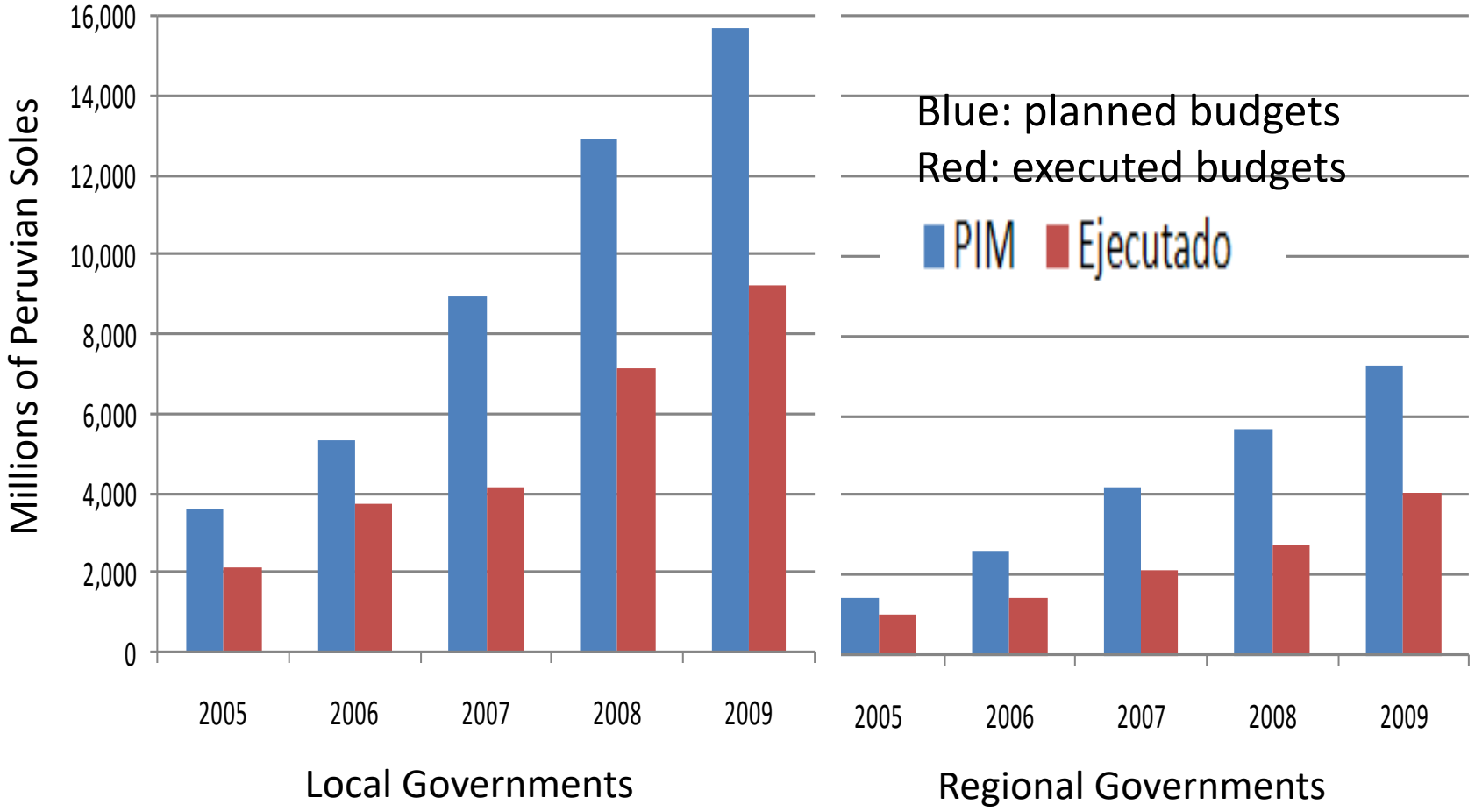
Rate of rejected and viable projects



Source: Frank and Garcia-Garcia, 2012, based on MEF-SIAF, SNIP

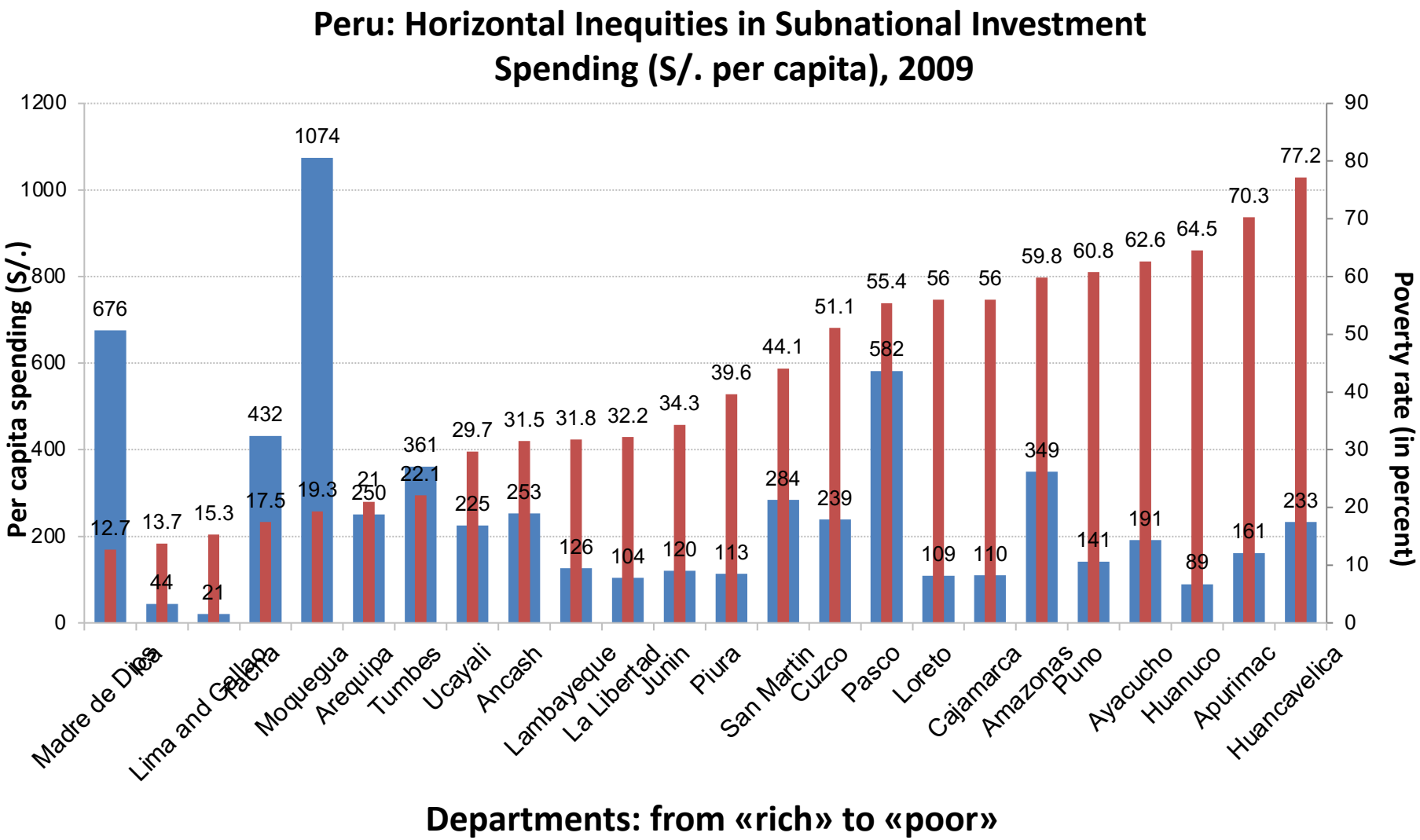
Absorption capacity

Example of Peru



Source: Frank and Garcia-Garcia, 2012, based on MEF-SIAF

Equity

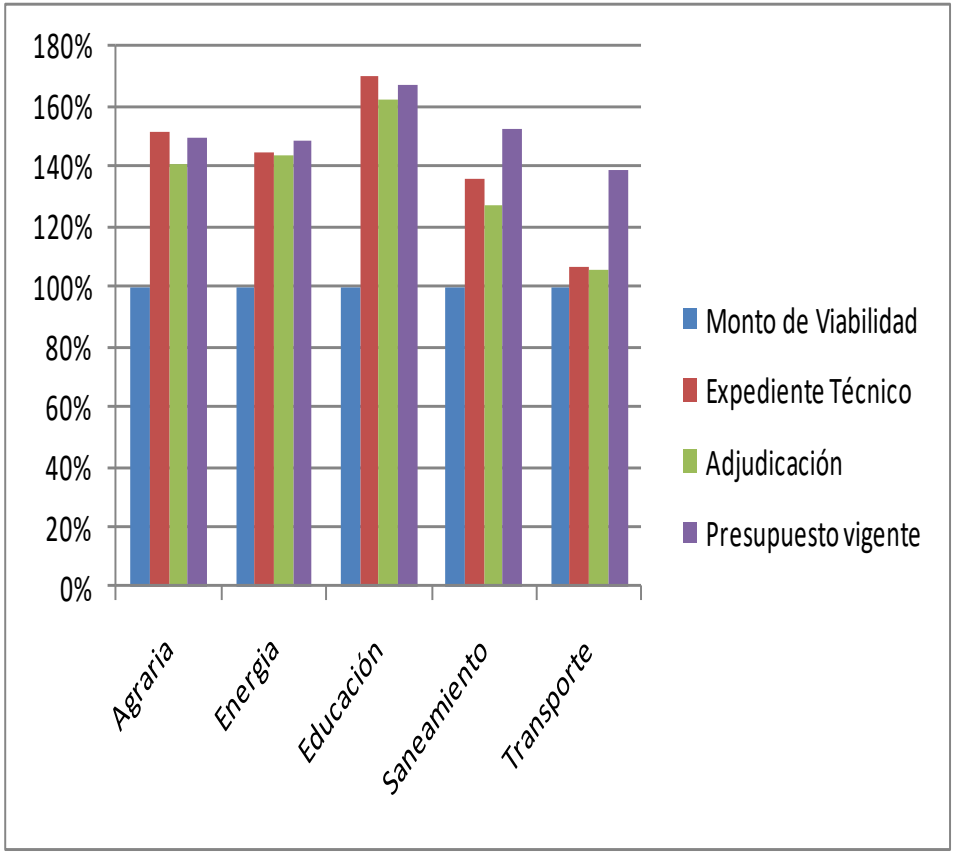


Source: Frank and Guerra-Garcia 2013, based on MEF (SIAF), INEI.

IV. WHAT EXPLAINS INEFFICIENCIES? A LOOK AT SOME OF THE DRIVERS AND INCENTIVE PROBLEMS

Optimism bias: differences in amounts between planned and approved budgets

Cajamarca case - Peru



Blue: planned budget (pre-investment stage); *Red:* evaluated projects; *Green:* approved budget; *Purple:* approved budget

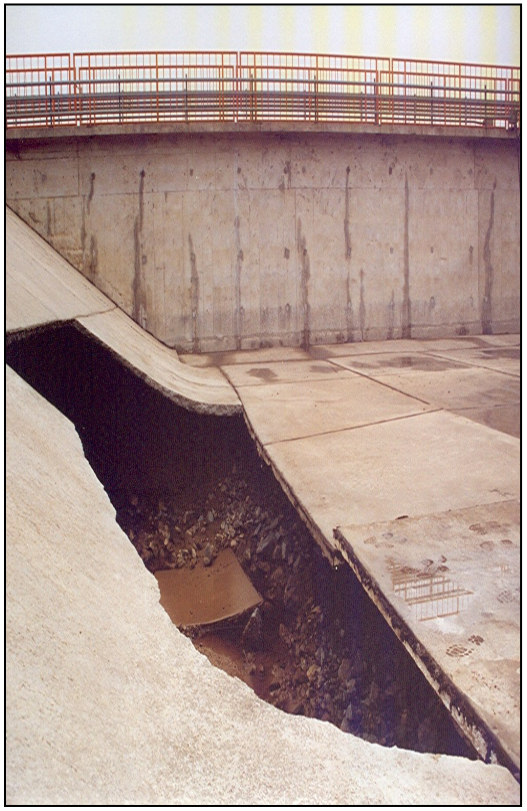
Source: Cajamarca Regional Government

Volatility in funding – multiple root causes

- Public investment as fiscal adjustment variable:
  - Upwards, downwards
  - Fiscal stimulus plans post-2008/9 crisis
- Co-financing
- Competitive allocation
- Transfers to SNG: different level of risk sharing among levels
- Natural resources
- Differing preferences

Dilemmas of un-bundling: Operation and maintenance

- Some O+M is invisible: not always local advantage
- Optimism bias - favor new works over O+M
- Incentives for O+M if infrastructure not in line with local interests?
- Technical capacities
- Cross-subsidies for O+M? – Exception: user fee financed



Picture: A. Zamalloa

"I think they just ate the funds. Do you see a school here?"

A man from Likoni, a poverty ridden area on the outskirts of Mombasa, Kenya

Source: Open Budget Survey 2012

Vulnerability to Corruption – Selected Sectors

Water and Sanitation	Land acquisition, selection of contractors, bid rigging, compromising quality, bribes for connections, meter tampering, conflict of interest with officials involved in private provision, collusion with companies offering bottled water or tanker provision
Roads	Land acquisition, rehabilitation, selection of contractors, false procurement and maintenance expenditures, quality of construction
Electricity	Public utilities: Land acquisition, rights of way, rehabilitation, equipment purchase and repair mark ups, patronage appointments, defective meters, meter tampering, theft of electricity by tapping distribution lines with side payments, connections delays, false billing, response to non-payment of bills, false subsidy payments Private utilities: Selection, regulatory regime, price hikes, blind eye to capital deterioration
Hospitals	Ghost hospitals, false procurement and construction
Schools	Ghost school, false procurement and corruption

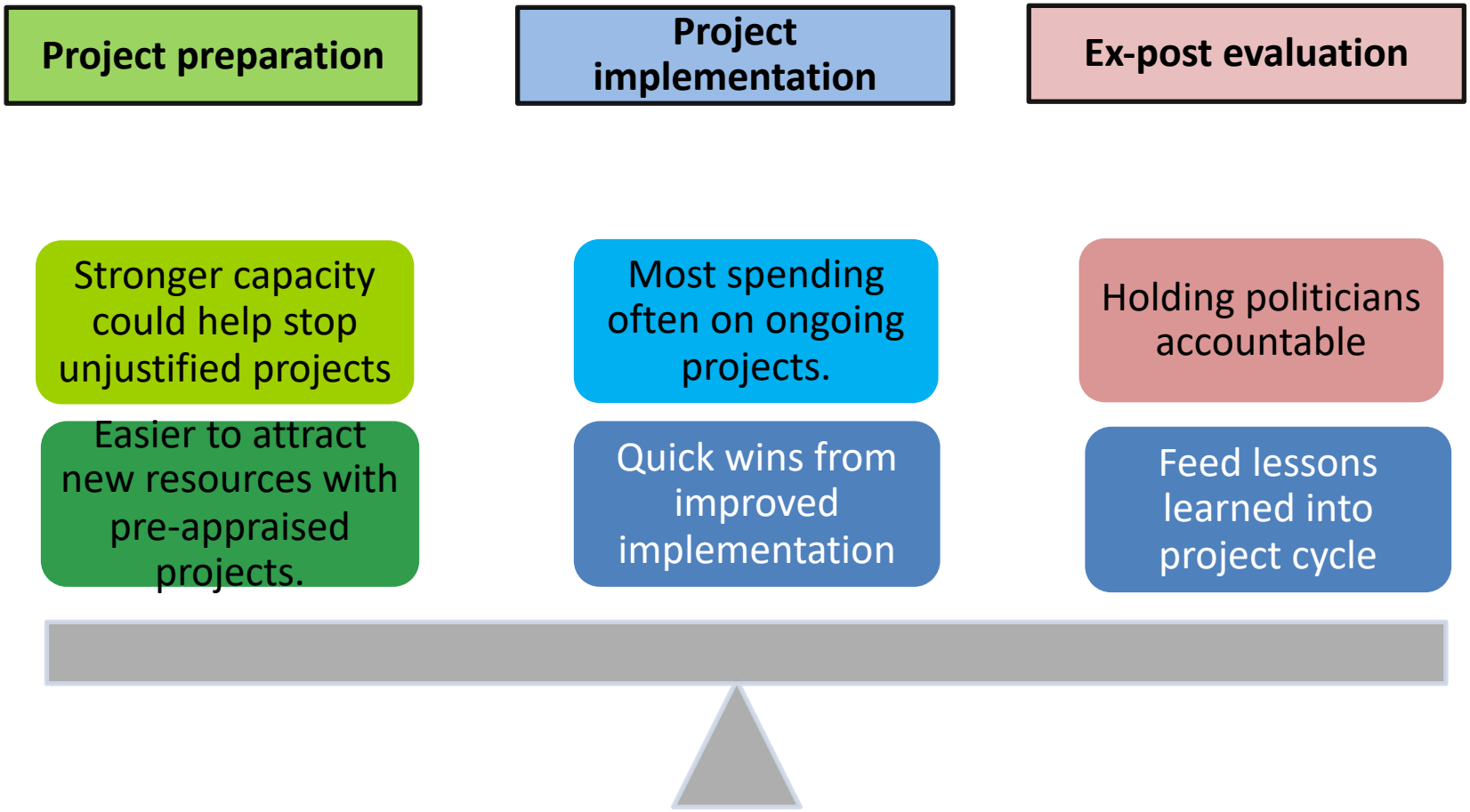
Source: Shah 2015, forthcoming

V. FROM GAPS TO SOLUTIONS: SELECTING ENTRY POINTS

Principles of decentralization: important additions

- Assymetry → tailored to gaps
  - Metro/Urban vs. Rural SNG
- Flexibility → tailored to sectors and projects
- Gradualism → quick gain
  - Choose sectors
  - Steps: procurement

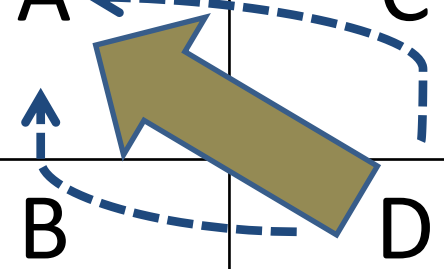
Where to start: Preparation, implementation, or ex-post evaluation?



Gate keeping

Set incentives for whole investment cycle … but there are trade-offs: strengthen appraisal or implementation first?

		Strengthen implementation	
		Well executed	Poorly executed
Strengthen appraisal	"Good" projects	A	C
	"Poor" projects	B	D



Fiscal incentives

- Subnational tax sets desirable incentives (Viñuela 2015)
- Co-financing schemes:
  - Signalling of priorities
  - Reveals demand of SNG
  - Technical Assistance
- Maintenance grant
- Earmarking: once responsibilities are consolidating

Enhancing equity

- **Social services (hospitals, schools):**
  - Incorporate into recurrent equalization grants (large operation and maintenance costs)
- **Fee recoverable infrastructure (utilities):**
  - Credit facilitation + fiscal responsibility
- **Non-fee recoverable infrastructure (no-toll roads):**
  - Conditional grant

Procurement: example for intergovernmental capacities

- **Differentiate responsibilities:**
  - Central: complex, tailor-made projects (irrigation; hydraulic structures; solar energy; etc)
  - Local: modular projects (school buildings; etc)
- **Approaches:**
  - By size of SNG
  - By financial cost
  - By sector
  - By type of project

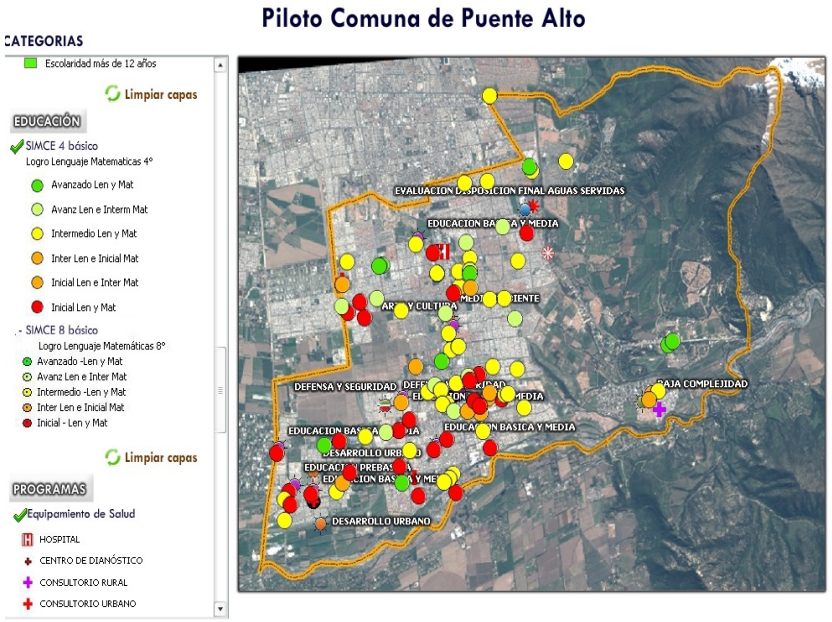
Towards further integration of financial management and information systems

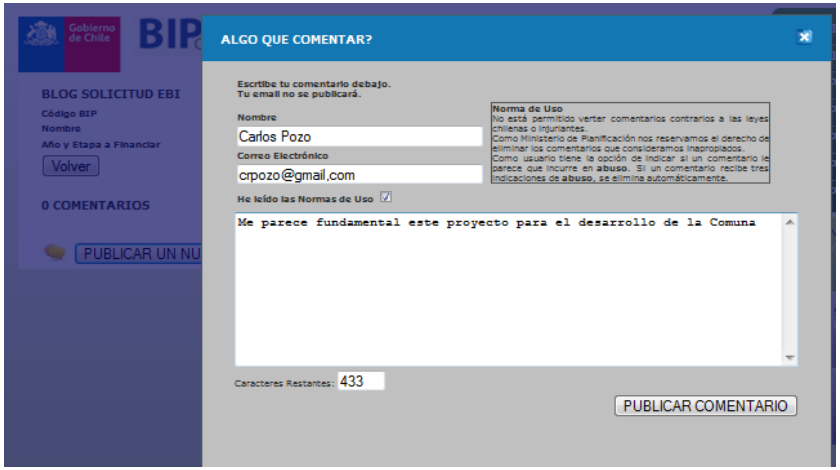
Country	Interface IFMIS vs SNIP	Single project code in IFMIS
Brazil	yes	yes
Colombia	yes	yes
Chile	yes	yes
Costa Rica	no	no
Guatemala	no	no
Honduras	yes	yes (social investments)
Paraguay	no	yes (in execution stage but not at pre-investment level)
Perú	no	yes
Bolivia	no	yes
Uruguay	no	yes

Source: IDB Survey 2009-2010 and World Bank

Strengthen the demand side

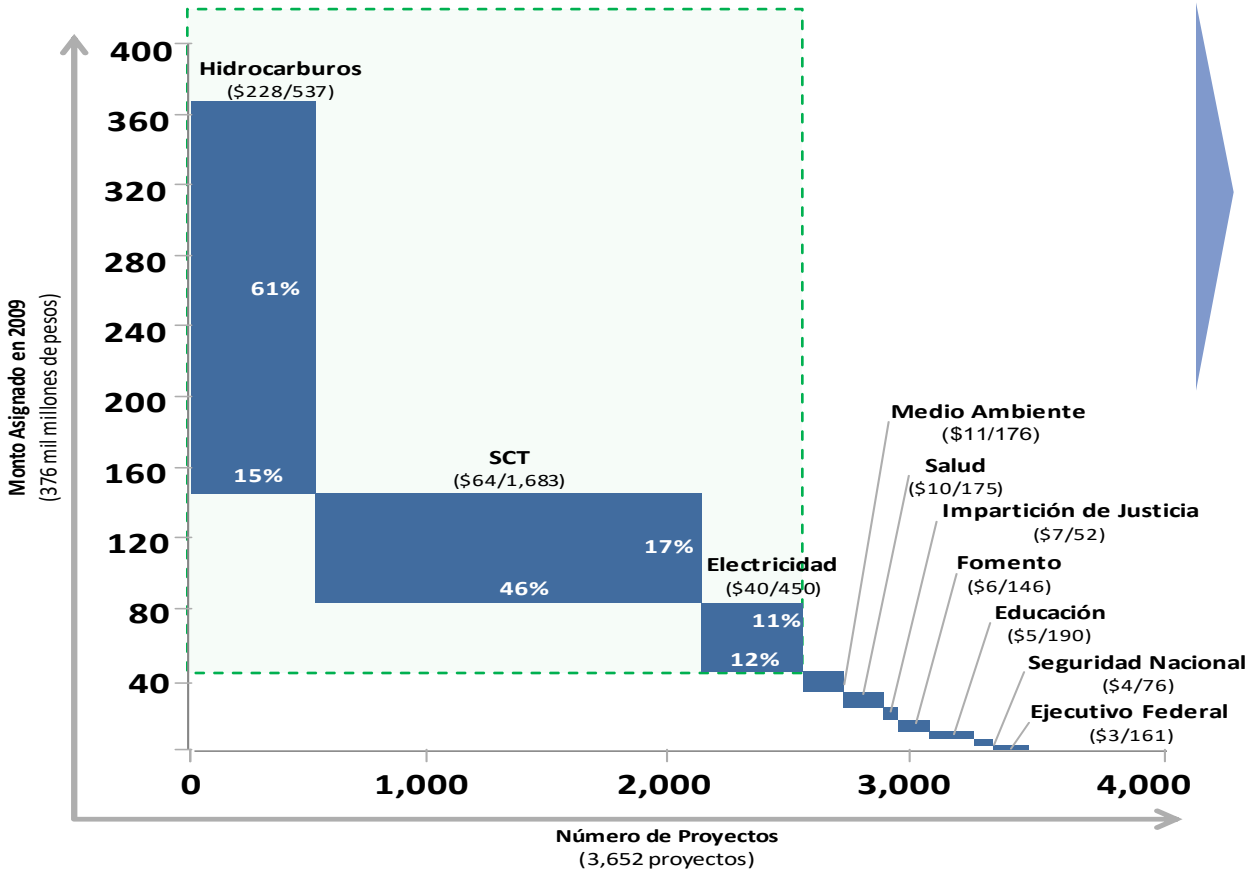
- **Interactive tools open to citizens and users**
- **Geo-referencing**
- **Expenditure tracking**
- **Benchmarking**
- **Ex-post evaluation**





Quick-gain strategy can prove effective - but do not lose sight of overall coherence

Quick-gains strategy in Mexico: focus on high expenditure areas



About 90% of investment is concentrated in three sectors: hidrocarbon, communications/transport and electricity

Fuente: Subsecretaría de Egresos de la SHCP/ Tomo VII PEF 2009 / Análisis Deloitte

Investing into the Invisible: Coordination

- Not a substitute for proper definition of responsibilities
- Signaling – Conditionalities - Contracting
- Approaches:
  - Vertical and horizontal
  - Sector and territories
- Fitting the intergovernmental context

Main messages

- SNGs play a fundamental and increasing role in provision of infrastructure
- Needs systemic view, but focus on the «good enough»
- Place- and context-specific approach
- Future drivers:
  - Better informed and more demanding citizens
  - Politicians' renewed interest in planning and budget goals

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Jonas Frank
Jorge Martinez-Vazquez

Georgia State University | Andrew Young School of Policy Studies

DIRECTIONS IN DEVELOPMENT
Public Sector Governance

The Power of Public Investment Management

Transforming Resources into Assets for Growth

Anand Rajaram, Tuan Minh Le, Kai Kaiser, Jay-Hyung Kim, and Jonas Frank, Editors

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