Tanzania Investment and Consultant Group Ltd

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Upfront the long-term impacts of Public Investment

Upfront the long term of Public Investment to Macro-economic Growth

Summary

The way public investment is defined and measured across countries varies. In general, it refers to investment on physical infrastructure (e.g. roads, government buildings, etc.) and soft infrastructure (e.g. innovation support, research and development, etc.) with a productive use that extends beyond a year.

Capital expenditure: consists of investments (i.e. gross capital formation and acquisitions, less disposals of non-financial non-produced assets) and capital transfers (i.e. investment grants and subsidies in cash or in kind made by subnational governments to other institutional units). Gross fixed capital formation (or fixed investments) is the main component of investments.

Public investment shapes choices about where people live and work, influences the nature and location of private investment, and affects quality of life. When done right, public investment can be a powerful tool to boost growth and provide right infrastructure to leverage private investment. In contrast, poor investment choices or badly managed investment waste resources, erode public trust and may hamper growth opportunities.

Introduction

public investment across levels of government limit efficiency and effectiveness:

1. Co-ordination challenges:
Cross-sectoral, cross-jurisdictional and intergovernmental co-ordination is necessary, but difficult in practice. Moreover, the constellation of actors involved in public investment is large and their interests may not be aligned.

2. Sub-national capacity challenges:
Where the capacities to design and implement investment strategies are weak, policies may fail to achieve their objectives.

3. Challenges in framework conditions:
Good practices in budgeting, procurement and regulatory quality are integral to successful investment, but not always consistent across levels of government.

The purpose of these journal is to help governments assess the strengths and weaknesses of their public investment capacity across levels of government and set priorities for improvement.

① Invest using an integrated strategy tailored to different places

a. To link investments to the specific needs of each region or locality

Public investment choices should be linked to a development strategy based on an assessment of the potential opportunities for, and impediments to, growth in each region (or locality). Investment strategies should be results-oriented (with clearly defined policy goals), realistic and well- informed (based on evidence that points to the region's ability to make fruitful use of investments), and forward looking (with investments that can position regions for competitiveness and sustainable development in the context of global trends). The investment mix will inevitably vary to reflect the specificities and assets of different places – such as urban and rural locations.

b. To join up related investments across policy sectors

Public investment serves multiple objectives – well beyond growth, linked to inclusive development or environmental objectives, which need to be understood in complementarity from the early stages of the planning process. Investments in both "hard" and "soft" infrastructure at the regional level are needed to maximise potential for long-term growth. It is important to seek complementarities and reduce conflict among sectoral strategies. For example, investments in housing need to be complemented by the right investment in transport networks. Such complementarities often need to be constructed and combined into integrated strategies.

c. To invest on the basis of well-informed and evidence-based strategies

Good data can support good decisions. Governments should encourage the production of data at the right territorial scale to inform investment strategies and produce evidence for decision making. For example, data at only a city level may limit the capacity to make strategies at the scale of the metropolitan area.

② Reinforce the expertise of public officials and institutions involved in public investment, notably at sub-national level

a. To address the increasingly complex tasks linked to public investment

Sub-national governments are increasingly involved in complex tasks linked to investment across the full life-cycle of projects, not least to address new regulatory constraints linked to the renewal of infrastructure to fight climate change. They also increasingly use more complex financial instruments, which require new competencies and new more networking-type skills not previously held in many sub-national governments.

b. To develop institutional capacity and professional skills for better investment decisions, in particular in small sub-national governments

Large regions, particularly established ones with substantial autonomy and significant numbers of staff, can tap a diverse range of professional skills. The same is not necessarily true for small regions, municipalities, newly created regions, or sub-national governments where decentralisation has out- paced corresponding growth in administrative capacity. Such challenges can hit particularly hard rural areas. Attracting needed skills to the public sector is a challenge for many regions where salary scales are uncompetitive with the private sector. Local governments also compete with each other and central governments to attract talent.

c. To enhance sub-national government access to skills and external support

This can be available through other governmental entities or outside of government through universities, technical consultants, quasi-public agencies. This is particularly relevant for sophisticated projects, such a "mega-projects" or projects with network characteristics, technical requirements may extend beyond standard project appraisal skills and require specific types of expertise (e.g. engineering)

③ Adopt effective instruments for co-ordinating across national and sub-national levels of government

a. To bridge a series of fiscal, information, or policy gaps that may occur across levels of government

Effective public investment across levels of government requires substantial co-ordination to bridge a series of information, policy or fiscal gaps that may occur. Collaboration for public investment strategies across jurisdictions and levels of government is difficult, even in situations where the actors involved clearly recognise the need for it. Transaction costs, competitive pressures, resource constraints, differing priorities and fears that the distribution of costs or benefits from co-operation will be one-sided, can all impede efforts to bring governments together.

b. To identify joint investment priorities and minimise the potential for investments to work at cross-purposes

The scale and positive (or negative) spillovers of a public investment may require joint action, either to reduce the cost of the investment or to implement the complementary measures needed to make the most of that investment. While co-ordination on all aspects of public investment is not necessarily feasible, at a minimum, there is an aim to avoid contradictory approaches across levels of government.

④ Focus on results and promote learning from experience across levels of government

a. To focus on investment outcome goals and pursue them throughout the investment cycle at all levels of government

Focusing on results include, but are not limited to, investment strategies with well-defined policy goals, performance budgeting, well-designed tendering procedures and performance monitoring of procurement, technically sound project appraisals, effective investment monitoring systems and high-quality ex post evaluation.

b. To monitor the implementation progress of projects

Monitoring the implementation progress of projects can be done in terms of inputs, activities, and outputs; and evaluation through intermediate and final outcomes and their alignment with strategic goals. Outcomes of an investment may take three, five, or more years to be measureable, and thus the monitoring indicators need to be tracked years after the investment is made, and often beyond an election cycle. Indicator systems should balance comprehensiveness and usefulness without unnecessary administrative burden.

c. To promote learning from experience and previous mistakes

Learning happens over time, but only if information produced in a first step is used in a subsequent one. Evaluation addresses the goals of investment, assessing if the intended outcomes were achieved and the role played by investment activities. Information that emerges from monitoring and evaluation systems should feed into decisions regarding investment in subsequent investment cycles.

d. To allow for some flexibility and reconsideration of initial priorities, to adjust to evolving priorities and context throughout the investment implementation.

⑤ Develop a fiscal framework adapted to the investment objectives pursued

a. To define appropriate intergovernmental fiscal arrangements which determine to a large extent sub-national government financial capacity to invest

Choices regarding sub-national transfers, own revenues and borrowing should reflect good practice, fit a country's institutional context and align with policy objectives. This may allow in certain cases for different fiscal arrangements across different territories in order to better fit with the variety of local situations/capacities.

b. To encourage sub-national governments to play an active role in investment and

development

Higher levels of government should set enabling conditions for sub-national governments to be able to exploit their own revenue-raising potential to finance investment, to ensure financing for long term operations and maintenance, and to participate in co-financing arrangements.

c. To align priorities across levels of government

Co-financing schemes should be more than a way for sub-national governments to secure funds. They can help to ensure the commitment of different actors to the success of a project and create collective ownership; to align investment priorities across levels of government; or to encourage sub-national authorities to engage in projects with positive spillover effects or to pool resources with neighbours

⑥ Co-ordinate horizontally among sub-national governments to invest at the relevant scale

a. To reduce duplication of unsustainable investments due to inter-jurisdictional competition

There are many reasons why sub-national horizontal co- ordination is essential to encourage investment. The small scale of public investment projects in countries with high levels of administrative fragmentation can result in lower returns on that public investment. The fragmentation may also result in an insufficient minimum scale for the investment to even be considered at all.

b. To promote economies of scale

Horizontal co-ordination is essential to increase efficiency through economies of scale and to enhance synergies among policies of neighbouring (or otherwise linked) sub-national governments. Investing at the relevant scale implies to identifying the “functional scale” for the investment under consideration. The functional area is a variable geography that depends on the function, be it for school districts, hospital services or commuter rail. It is likely to be easier to encourage co-ordination around investments in basic infrastructure and service provision (e.g. water sewage) and more difficult around “strategic” investments where sub-national governments might find themselves competing to secure public facilities, to attract intergovernmental grants, or to attract private investment and qualified persons. Overcoming juris- dictional barriers requires the capacity to see and execute the opportunities, while gathering the necessary political support.

c. To manage positive and negative spillovers among neighbouring regions

There is some quantitative evidence that benefits of public investment in neighbouring regions can be just as important, or more, than direct public investment in that region. For example, a rural region close to an urban region will strongly benefit from improved transportation infrastructure in the urban functional areas

⑦ Mobilise private actors and financing institutions to diversify sources of funding and strengthen sub-national capacities

a. To bridge the infrastructure financing gap

There are important and growing gaps in infrastructure development, in both developing and developed countries. To support a future global population of 9 billion people, the OECD has estimated the global infrastructure gap to be USD 70 trillion by 2030, and that this gap will continue to grow. Neither governments, nor multilateral development banks, can finance large global infrastructure needs on their own, so greater private sector investment is needed (G20, 2014).

a. To benefit from the private sector’s expertise and financing

Governments should look to private actors, financing institutions and banks for more than just financing. Their involvement can strengthen capacities of governments and bring expertise through better ex ante assessment of projects, improved analysis of the market and credit risks, and identification of cost-effective projects.

b. To develop public-private partnerships (PPP) at the sub-national level, with careful consideration of the risks involved

Careful consideration of private engagement includes careful analysis of the pros and cons of different private participation arrangements and what they entail in terms of risk and government financial and administrative capacity. Inappropriate financial decisions by sub-national governments to develop PPPs, for example to hide bad financial health off balance sheet, can have significant financial impact over the longer term. PPPs should be treated soundly in the budget process, with proper accounting and disclosure of all costs, guarantees and other contingent liabilities.

a. To enhance new or innovative financing arrangements for sub-national public investment

To address the financing gap, new or innovative financing arrangements such as loans, bonds, specific investment funds, tax arrangements, or market-based mechanisms may be useful to finance infrastructures and green investments. Sub-national governments should use innovative financing instruments with an understanding of the capacities needed, as in some cases they could severely compromise local finances and cause risky dependence vis-à-vis financial markets.

⑧ Require sound and transparent financial management at all levels of government.

a. To ensure budgetary and financial accountability at all levels of government

Proper costing and budgeting serve to prioritise and execute investment programmes effectively. Robust financial controls bolster accountability. Governments at all levels should therefore adopt good practices in favour of budgetary and financial accountability, as defined in the Principles of Budgetary Governance, such as accurately costing public investment plans, reflecting them in budget strategies and allocation processes, fitting them into a medium-term budget framework and duly considering long-term operating and maintenance costs.

b. To enhance transparency with citizens and other stakeholders

Such transparency applies to all levels of government. Budgetary transparency throughout the investment cycle provides visibility to investments, clarifies recurrent budgetary implications, and strengthens public account- ability. Governments should make budgetary information regarding public investments publicly available to citizens and other stakeholders in a timely and user-friendly format. Transparency with respect to local public enterprises, often recorded in separate budgets, is a critical element for a clear picture of sub-national finances.

c. To ensure national fiscal stability

Bad budgeting and financial practices at the sub-national level with respect to investment can have a cascading/contagion effect on other sub-national governments and on the national government. If sub-national governments accumulate unsustainable levels of debt, they may then require (and often obtain) implicit or explicit central bailouts to prevent a default.

⑨ Strive for quality and consistency in regulatory systems across levels of government

a. To promote a regulatory framework conducive to both public and private investment at the sub-national level

Divergent, overlapping, contradictory or constantly changing regulations can impose costs (particularly for sub-national governments), reduce efficiency and deter investors. Regulatory coherence is of particular importance in network sectors, such as power, telecommunications and water, owing to the greater degree of regulation to which such activities are typically subject. Even relatively basic public works projects may be impeded by a lack of regulatory clarity or coherence. And the private sector may stay away, experience delays, or even abandon a project if there are issues in the regulatory framework or a problematic procurement process.

b. To enhance the regulatory capacity of sub-national governments

Sub-national capacity for regulatory quality is an integral aspect of effective public investment. Sub-national governments should be able to implement regulation from higher levels of government effectively, as well as to define and implement their own strategy for regulatory management, including the assessment of regulatory impact and reforms needed. Special attention should be given to administrative simplification which could help involve private partners in public investment strategies.

⑩ Assess upfront the long-term impacts and risks of public investment

a. To identify social, environmental and economic impacts and ensure value for money
In a large number of cases, the root of the problem for the management of public investment is insufficient or weak planning: poor selection of projects, weak project appraisals not based on sound data, and optimism bias. A majority of countries consider the lack of evidence for the choice of investment mix by sub-national governments to be a problem. Comprehensive, long-term assessments can help clarify goals and reveal information that can be used to refine investment selection. It is important for appraisals to be technically sound to identify social, environmental and economic impacts; and reveal which investment method is likely to yield the best value for money.

The challenge of ex ante appraisal is likely to be greatest where it is most needed: where there is considerable uncertainty about the factors affecting returns on investment. Commonly used approaches to economic assessment, such as cost-benefit analysis, are most effective where there is a great deal of information about the project, the context, and the risks involved over the investment cycle. For sophisticated projects, technical requirements may extend beyond standard project appraisal skills and require specific types of expertise (e.g. engineering).

b. To explore alternatives to investment and assess long-term operational and maintenance costs in infrastructure investment
Policy makers should consider policy and project complementarities, as well as alternatives to investment and efficient use of existing stocks to reach particular goals. Because infrastructure investment tends to involve large-scale, often irreversible projects, it is crucial to ensure that existing stocks are used efficiently before investing in new capacity. Long-term operational and maintenance costs, which are often under-estimated, should also be fully assessed and planned for early in the investment cycle.

c. To measure different types of risks
While growth objectives are crucial, an exclusive focus on growth may neglect important social or environmental costs or benefits of an investment. Integrating assessment of different types of risks associated with public investment (not only fiscal, such as contingent liabilities, but also financial, political, social and environmental risks), including longer term impacts, are an important part of an appraisal. Such risks and adapted mitigation strategies should be re-evaluated as new information becomes available. There can be risks pertinent to a particular region or locality which should be considered as part of this assessment.

⑪ Engage with stakeholders throughout the investment cycle

a. To better meet citizens' needs and enhance trust in government
Public investment projects, especially if they concern large infrastructure projects, are often highly politicised and susceptible to being undermined by a lack of consensus building. Stakeholder consultation at different levels of government is of key importance to build consensus and ensure transparency as to how the project meets the needs of directly affected citizens and society at large. Public investment information, such as expenditure data, should be exposed to public scrutiny to promote transparency and accountability.

b. To benefit from civil society and citizens' inputs in priority-setting and impact assessment
Public, private and civil society actors all have a stake in and a critical role to play in developing a vision and strategy for the economic future of a region or locality. All levels of government should involve stakeholders in priority-setting and needs assessment at early stages of the investment cycle, and feedback and evaluation at later stages. At a minimum, this involves identifying relevant stakeholders, designing sound consultation processes, communicating processes and results, and managing grievances.

c. To prevent capture by special interest groups
Governments should also take steps to prevent "capture" by special interest groups, such as seeking balance when incorporating stakeholder views, ensuring consultation processes are inclusive, open and transparent and promoting transparency and integrity in lobbying.

⑫ Promote transparency and strategic use of public procurement

a. To ensure transparent sub-national procurement systems
On average, general government procurement accounts for 13% of GDP and nearly a third of government expenditures in OECD countries. 55% of procurement is under-taken at sub-national level. It is one of the government activities most vulnerable to waste, fraud and corruption. However, sub-national governments often lack procurement know-how or specialised personnel. Problematic systems can compromise the integrity of the investment process, deter investors and compromise the achievement of policy objectives. Transparency throughout the procurement cycle, professionalisation of the procurement function, and clear accountability and control mechanisms are all required.

b. To enhance the use of procurement by sub-national governments as a strategic tool
In addition, governments should use procurement to ensure effective public service delivery while pursuing strategic government objectives – not only value for money and integrity, but also wider objectives such as greening public infrastructure, adapting to climate change, supporting innovation or SME development.

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