



OECD Development Finance Network (DeFiNe) Annual Assembly

Public Expenditures and Infrastructure
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SUMMARY RECORD

Background papers and presentations are available via the site www.oecd.org/dev/define.

Introduction

Regis Avanthay, Partnerships and Networks, OECD Development Centre

The following background to the meeting was presented:

- The importance of Domestic Resource Mobilisation as a running theme for the Global Forum on Development (GFD), in the context of (i) post crisis resource management, (ii) creating predictability in public finance, (iii) momentum created by G20 process – G20 Development Working Group and G20 Development Action Plan;
- Next GFD on Public Expenditures as continuity to the last year's GFD on Public Revenues – Taxation Challenge. Moreover, the two are related as there is a vital link between public spending and revenue collection in the form of fiscal legitimacy in public policy, and the resulting social contract between the government and taxpayers;
- Focus on Infrastructure fitting the Infrastructure Pillar (I) of the G20 Development Action Plan;
- In the new program of work (2011-12), DEV to study various aspects of infrastructure financing both at the regional level, through its outlooks;
- Meeting's main focus on building public sector capacity for infrastructure development and exploring ways to improve the effectiveness of public expenditures on infrastructure (i) across sectors, (ii) through budgetary execution, and (iii) as a catalyst for private investment;
- Morning sessions – focus on sectors and discussing (i) infrastructure for competitiveness and (ii) infrastructure for social inclusion;
- Afternoon sessions – focus on public sector capacity in executing infrastructure projects; (i) Public sector capacity in general but especially budgetary execution - a systemic assessment of infrastructure policy processes as a whole is needed, from planning through spending to delivery, and an overall coordination between the different steps of infrastructure projects. (ii) Enabling environment for private sector involvement in infra development (regulation, monitoring, incentives, sanctions...), with major part given to PPPs.

Morning: Infrastructure for Development

Setting the scene

Infrastructure patterns in emerging markets

Christian Daude and Angel Melguizo, Americas Desk, OECD Development Centre

An empirical study on cross-country infrastructure patterns which finds that:

- Infrastructure is key for potential growth, development and stabilization policies (e.g. G20 agenda), whereby growth and inequality gaps Asia-Latin America can be explained by infrastructure gaps – less spending implies lower quality of services;
- Emerging economies still present significant infrastructure gaps: Latin America lags behind Asia and emerging Europe; significant differences exist across infrastructure types (basic, transport, energy and telecommunications) and countries;
- Policy response should focus on building better institutions (quality of bureaucracy, fiscal position) and improving regulation (in particular around public-private financing).

Infrastructure and regional integration - Southeast Asian Economic Outlook (SAEO)

Kiichiro Fukasaku, OECD Development Centre

The forthcoming SAEO 2010, whose thematic focus will be on Transport Infrastructure and Regional Integration in ASEAN region, stresses that:

- Transport infrastructure development is central to promoting ASEAN integration and reducing gaps among and within its member countries.
- Indonesia's transport infrastructure is less developed than that of other middle-income ASEAN members but a number of steps are being taken to improve the situation.
- New financing method can promote private infrastructure investment in Southeast Asia (PPP/revenue bonds in Thailand)
- ASEAN economies have emerged strongly from the global crisis, but development is likely to be uneven across countries and sectors, unless necessary measures are taken:
 - Foster regional and sub-regional connectivity through infrastructure development;
 - Support new growth areas in ASEAN priority sectors;
 - Institute a credible medium-term fiscal framework to support rebalancing growth.

Session 1: Infrastructure for competitiveness (transport, energy, communication)

Chair: Christian Daude, Americas Desk, OECD Development Centre

The purpose of this session was to hear examples of infrastructure questions, dilemmas and policies in the three key areas which matter for country's competitiveness in product markets, services and trade – transport, energy and communication.¹

Road infrastructure: An obstacle for economic growth in Colombia

Mauricio Olivera, Fedesarrollo, Colombia

This presentation discussed transport in Colombia, and mentioned in particular that:

- Colombia has a wide coverage in the provision of water utilities given its GDP per capita;

¹ Ewan Sutherland's presentation on ICT in Africa had to be cancelled at last minute notice. We apologise for this.

- On the other hand, the percentage of total paved roads in Colombia is low given its GDP per capita and gross capital formation.
- This low performance might be attributed to
 - Geography
 - Political Economy and Institution.
- Main policy recommendations would be:
 - Strong institutions, one for project structure and road design (Ministry of Transport), one for financial structure (Ministry of Finance or National Planning Department);
 - Higher equity requirements in order to attract institutional investors, let the construction companies construct and to avoid conflict of interests;
 - Avoiding periodic renegotiations (311 in all concessions since 1997) to cut down on low power incentives: first win the concession, and then renegotiate.
 - Private participation in regional (secondary and tertiary) roads.

Transmission and distribution of electricity in India - Regulation, investment and efficiency

Yoginder Alagh, IRMA, India

The speaker shared lessons learnt from reforms of the system of transmission and distribution of electricity in India:

- Experiment with alternative administrative and bidding procedures in the unbundling process of transmission and distribution.
- Move away from cost plus pricing at the earliest; loss minimization strategy is a variant of a long term marginal cost pricing strategy.
- Use merit-order despatches.
- A transparent regulating system and the infrastructure of transmission and distribution needs to be set up at the earliest. The Central and State Electricity Regulatory commissions and the Appellate Tribunal for Electricity (ATE), SEBs disaggregated into Generation, Transmission and Distribution Companies, various policies like the National Electricity Policy, Tariff Policy, Rural Electrification Policy mandated by the Act, along with Rules and Regulations have to be in place. Trading licenses have to be issued, power trading has to commence. National Grid Code and State Grid Codes have to be notified. Only then unresolved problems can be taken up. Persist with reform ideas at the highest political levels. The successes of private transmission and availability tariffs in the initial stages and later problems underline this. These aspects need to be integrated in case studies of reform, which in turn have implications for negotiating reform packages.
- Technological improvement packages, say as in open access programs, need to be accelerated and the Indian experience shows that - while the important issues lie in the reform and unbundling package - the technical packages have a usefulness of their own.
- Equity aspects need to be embedded in the program of reform, recognizing fully well the difficulties in a structured subsidization policy.
- Reform itself will make most electricity investments viable; sectoral and company level prudential rules may need careful review in view of the lumpy nature of power investments. Long Term Financing institutions, Infrastructure lending Banks and experienced regulation by central bankers may be needed to fund otherwise viable projects.

Session 2: Infrastructure for social inclusion (water, sanitation, health, education)

Chair: Henri Bernard Solignac-Lecomte, Head of EMEA, OECD Development Centre

The purpose of this session was to discuss the importance of investment into pro-social infrastructure projects, investment which is traditionally in the domain of governments because of demand needs but supply constraints, high risk and low return, and generally due to the market failure whereby the allocation of the infrastructure good by the market would not be efficient.

Delivering Social Infrastructure through PPP: The Role of Non-Profit Organisation

Mustafizur Rahman and Debapriya Bhattacharya, Centre for Policy Dialogue, Bangladesh,

The speakers argued that that the second P of PPP stands for private sector, and that should include conceptually both for-profit and non-profit components:

- In the developing countries the government and non-profit private development sector (the other name for NGOs) has come together in providing health, sanitation, education and other related services to both rural and urban poor, addressing the problem of social exclusion.
- Benefits of using PPP include reduced public spending, efficiency, leveraging managerial expertise, spurring technology transfer and risk allocation.
- PPP examples in education India span various modes: design-build (education vouchers in Uttarakhand), design-build-operate (computer learning programs in Rajasthan), design-build-finance-operate (public schools in Andhra Pradesh), design-build-own-operate (education for disabled in Tamil Nadu).
- PPP examples in health in India have been recorded in the provision of mobile clinics, diagnostic services, ambulance and motor operations, community health care and health advice.
- In Bangladesh Policy and Strategy for PPP was published in 2010 and includes mention of social infrastructure; non-governmental sector has already collaborated with government or run own complementary programs, regarded as more effective, client-friendly and more utilised.
- An eminent example is BRAC support to formal education.
- Challenges for Private-Not-For-Profit Organisations: volatility in NGOs with respect to size, expertise, spread; limitations of funds; dependency on philanthropic donations.

Infrastructure in Education and Health Services

Abdallah Saaf, CERSS, Morocco

This presentation examined the improvement of investment in infrastructure of education and health and its shedding light on important aspects of and structure of public spending:

- There has been no change in the share of investment in both sectors as a percentage of the budget, looking even less impressive if measured against the entire government budget inclusive of fiscal debt and debt service.
- The combined share of spending in health and education infrastructure represents less than 10% (2007), 8% (2008) and 13% (2009) of the total government budget.
- Participation of the private sector and NGOs is purely symbolic, and local government which was once an important funder is now virtually absent.
- Opening both the health and education to the private sector is currently a concern on the part of the government, in spite of the little significance of current investment levels.

Pro-social infrastructure: an approach to public expenditure tracking

Fikret Toksöz, TESEV, Turkey

A public spending tracking project is undertaken in 6 pilot provinces in Turkey:

- The project includes poverty mapping, public expenditure analysis, service delivery surveys and participatory strategic planning.
- Main public service areas analysed are education, health, social services and infrastructure.
- Tools are developed and exercised in working groups of civil society and local authorities.
- Analysis aims to determine allocation of expenditure (where, how, who), increase public awareness about public expenditures, promote civil society participation at local level, develop proposals for central government regarding public funds allocation.
- Poverty mapping is done by taking neighbourhoods and villages as primary units of analysis, to depict different needs of different areas in provinces.
- Poverty indicators incorporate, for example, state of sanitation in households, levels of unemployment, literacy rates, visiting time to health centres, some other subjective measures.
- The study has shown, for example, that (a) the poor in Ankara have problems in meeting education needs of their children, (b) satisfaction with primary education, road quality and transportation is lowest in poor segments of Ankara.

Education Infrastructure for Social Inclusion in Uganda

Lawrence Bategeka, EPRC, Uganda

The speaker discussed the objectives and results of the education sector policies in Uganda:

- Introduction of Universal Primary Education in 1997 and Universal Secondary Education in 2007 led to significant increase in primary education enrolment and transition rate from primary to secondary schools.
- However the quality of education fell, in spite of government's efforts to increase the necessary infrastructure.
- Private schools took lead in offering quality education, but government attempted to control them via legislation so as to ensure access to education by the poor.
- Social divide which emerged is both geographical and income based, and technological advancement is making this divide worse.
- Following recommendations have been promoted: (a) a variety of choice in terms of curricula, academic delivery, medium and mode of instruction is needed; (b) education must be geared to ensure professional livelihood; (c) education must be accessible to all; (d) financial support and scholarships must be available to needy pupils; (e) education quality must be preserved; (f) investment in education infrastructure must be expanded enormously.

Infrastructure in Water and Sanitation

Celine Kauffmann, Directorate for Financial and Enterprise Affairs, OECD

The OECD's work on financing water infrastructures highlights the following key messages:

- According to the "OECD Environmental Outlook to 2030", almost half of the world population will be living under severe water stress by 2030 if no new policies are introduced. Even with pockets of water scarcity, the world globally has enough water, but it needs to manage it better and to finance the right infrastructure.
- Beyond building new infrastructure, the challenge is also to upgrade the existing one, ensuring a good co-ordination of the whole water system. (For instance, coherence between the size of treatment plants compared to the water network).

- To ensure financial stability, countries need to leverage all sources of finance, to find the right mix of ultimate sources of revenues (tax, tariffs, and transfers), and to channel these resources towards those who need it.
- Each country gives a different role to the private sector, but according to the “Private Sector Participation in Water Infrastructure: OECD Checklist for Public Action”:
 - private sector participation doesn’t relieve governments from their duties to regulate, plan and set up appropriate institutional frameworks;
 - multiple levels of governance (different jurisdictions, public agencies, etc.) make the private sector’s task difficult.

Infrastructure and Governance

Aziza Akhmouch, Public Governance and Territorial Development, OECD

In most cases, investment in infrastructure is a public responsibility. Beyond the public/private debate, accelerating the efficiency of this spending requires to overcome various governance challenges:

- the variety of interdependent actors involved (agencies, various levels of government);
- the bottlenecks for implementation on the ground;
- the administrative mismatch between hydrological boundaries and administrative functional units;
- the information gap between central administration and the local actors;
- the sectoral fragmentation of water policy making, since different ministries are involved (Environment, Agriculture, Industry, Finance, etc.);
- the capacity issues when responsibilities are decentralised.

Some tools have proven to be successful in bridging governance gaps and fostering good practices (Creation of ministries for water policies, line ministries, inter-ministerial commissions, high level structures, coordination of groups of experts, water agencies, etc.). However there is no single mechanism that a country could adopt to invest, operate, and maintain infrastructure.

Afternoon: Building Public Sector Capacity for Infrastructure Development

Setting the scene

Fiscal space and policy responses

José Fanelli, MERCUNET, Argentina

A project was undertaken to evaluate the interactions between macro volatility and fiscal space in the cases of Brazil, Argentina, Chile and El Salvador. The interest was to analyse the effects of volatility on the size of the Fiscal Space; this link operates via direct and indirect channels. The results achieved show:

- Volatility matters to Fiscal Space. In particular in 1980s and 1990s the government acted as insurer of last resort and the fiscal imbalances provoked by the bailout of the banking system eroded public debt sustainability, reducing the fiscal space; in 2000s LA countries adopted self-insurance strategies via reserve accumulation and primary fiscal surplus.
- Self-insurance and more fiscal space have been instrumental at reducing volatility: Argentina, Brazil and Chile implemented counter-cyclical policies; but self-insurance was associated with current account surpluses whereby valuable savings are diverted from productive and infrastructure investment. Preserving fiscal space to smooth the cycle may be instrumental at reducing the importance of self-insurance based on reserve accumulation and current account surplus.

- The stability of the policy regime and the ability to improve the rules of the game are not independent of the macroeconomic environment; (a) Negative example: the fall of the convertibility regime in Argentina; (b) Positive examples: fiscal responsibility laws and rules - in the 2000s Chile achieved the most successful and efficient enlargement of the fiscal space.
- The structural features of the economy determine the type of macro-shock and this hinges on the ability to generate fiscal space: (a) Argentina and Chile - Revenues heavily depend on terms of trade (natural resources); (b) Brazil and Argentina - Fiscal federalism matters; (c) El Salvador - The reduced size of the public sector heavily constrains the ability to increase the fiscal space.

Private Public Partnerships for Infrastructure Development

Ian Hawkesworth, Public Governance and Territorial Development Directorate, OECD

This presentation discussed the challenges in managing the risks and opportunities inherent to PPP projects:

- Since the 1990s an increasing number of countries use PPPs and PPPs are becoming popular with many low and middle income countries, because private sector has greater incentive and ability to deliver cost effective capital assets and tying service delivery with payment mechanisms may encourage faster construction and better continued maintenance over the contract life of the assets.
- This argument is based on the assumption of competitive markets, availability of finance, comprehensive contracts, government capacity and responsible business conduct.
- Value for money in PPPs can be assessed by a complete cost-benefit analysis of alternatives, a public sector comparator before bidding, a public sector comparator after bidding, use of competitive bidding process.
- Fiscal constraint argument should not bypass value for money or affordability.
- Institutional capacity to ensure value for money involves dedicated PPP units, offering policy guidance, technical support, capacity building and PPP promotion.
- Most PPP units do not green light projects but have some degree of gate-keeping.
- Interesting example is Korea, where PPP unit also considers all government investment projects, including PPPs.

Session 3: Budgetary execution for infrastructure projects

Chair: Johannes Jutting, Head of Poverty Reduction, OECD Development Centre

This session focused on a systemic assessment of infrastructure policy processes as a whole, from planning through spending to delivery, and an overall coordination between the different steps of infrastructure projects. Lessons were drawn as to which are the most difficult steps or bottlenecks. We zoomed onto budget execution, which is a considerable problem in many developing countries, yet receives relatively little attention.

Public sector capacity and infrastructure projects

Claire Charbit, Public Governance and Territorial Development Directorate, OECD

This presentation discussed capacity and coordination challenges across levels of government:

- There is a strong need for a methodological diagnosis in order to shed light on complementarities, often needed at the territorial level in form of a comparative approach and selection of incentives for capacity building and coordination of public administration actions.
- In the above, sub-national authorities play an important role in what concerns public investment.

- But needed is a “Mind the Gaps” approach, a tool for a diagnosis of information, funding, policy, capacity, administrative, objective and accountability gaps.
- Finally, ways to bridge such coordination gaps are possible through contracts, performance measurement & transparent evaluation, grants, co-funding agreements, tax instruments, strategic planning requirements, multi-annual budget, inter-municipal coordination, inter-sectoral collaboration, agencies, experimentation policies, legal mechanisms and standard settings, citizens’ participation, e-govt, private sector participation, institutional capacity indicators

Budgetary execution for infrastructure projects

Sara Fyson, OECD Development Co-operation Directorate, and Laura Recuero-Vitro, OECD Development Centre

The speakers started by defining the national budget as government’s central instrument for economic management, reflecting the values and strategies of the country. Then they outlined the relevance of budgetary execution:

- Budgetary execution sits between the legislative and implementation phases in the budget cycle, ensuring aggregate fiscal control, strategic resource allocation, operational efficiency and external transparency.
- Budgetary execution involves appropriation and release of funds to spending units, commitment to meet future obligations, acquisition and verification (or certification) of service, and payment.
- Rules and procedures are (relatively) rigid and hierarchical in Latin America, while flexible and collegial in the OECD. They are slightly more transparent and using performance information in the OECD.
- Hierarchical and rigid budgetary institutions lead to under spending, while having multi-year commitments for projects and allowing funds to be carried over into the next year can soften this under spending. Here budgetary execution matters for infrastructure projects.
- Donors’ commitments to strengthen budget execution may enforce predictability and transparency of funding, putting aid ‘on budget’ and stronger public finance systems (including procurement).

Building a tool kit for choosing public policies in LDCs in the allocation of public investment to services and infrastructure projects

Lichia Saner-Yiu, CSEND, Switzerland

This presentation started by bringing in evidence that centralised decision making processes often fail to deliver the desired outcome. On the other hand, fragmented approaches to managing public finances are also known to generate unintended negative consequences, ranging from delays, overspending, to downright waste and public discontent. It was outlined that good infrastructure policy should:

- Be based on national development policy;
- Be linked with other governmental policies;
- Address domestic development disparity;
- Balance the interests of all key stakeholders;
- Take into considerations of the regional dimension and the international supply and value chains;
- Have a clear implementation plan with adequate resources.

Session 4: Enabling environment for private sector involvement in infrastructure development

Chair: Helmut Reisen, OECD Development Centre

This session focused on the importance of rebalancing the public/private mix for the provision and maintenance of infrastructure.

Development and financing public investment through Public-Private Partnerships

Pablo Souto, CEF, Argentina

Pablo Souto drew some lessons from the case of Argentina:

- Over the last few years, Argentina tried to implement various PPP regimes and regulations, without achieving any major Infrastructure PPP project so far.
- However getting value for money and an efficient distribution of risk is at the heart of PPP schemes. PPPs foster investment and therefore long-term growth perspectives, without any impact public expenditures and the fiscal balance.
- The conditions for a successful PPP include identification and prioritisation of investment needs, political commitment upfront and during the service delivery, and involvement of institutional investors.

Infrastructure financing challenge in Africa: A sub-national perspective

François Yatta, LEDNA, Niger

- One of the biggest challenges of Africa is the growing urbanisation and the eradication of slums. Gaps in infrastructure are a major obstacle to growth.
- Infrastructure is an opportunity to foster economic development, by increasing demand and factor productivity.
- Maintenance budget contributes to efficient strategies against poverty by giving contracts to local small and medium enterprises.
- National institutions specialised in infrastructure development experience a various mix of funding sources (public resources, aid, financial markets, credit from the central governments, etc.) and support modalities (grants, loans, guarantee, etc.).
- A regional approach is a key factor of success.

PPP in infrastructure: opportunities and challenges with special reference to Sri Lanka

Saman Kelegama, IPS, Sri Lanka

- Infrastructure development increases growth and regional inclusion. It also helps reduce poverty and inequality. PPPs are a collaborative instrument to finance the infrastructure gap, especially in times of a crisis, when tax revenues and concessional donor funds tend to decrease.
- They also encourage Foreign Direct Investment (FDI) and transfer of international best practices. The Indian case shows how successful reforms in transport and telecom infrastructures helped attracting private sector investment.
- Policy-makers need to address the following challenges:
 - implementing sophisticated judicial mechanisms and strong contract laws (because of the large number of stakeholders and long duration of the projects);
 - improving the public sector technical and administrative capacity, to reduce red tape and bureaucratic delays;
 - strengthen transparency, to avoid rent-seeking amongst both government and the private sector;

- reinforce financial market sophistication to secure long-term investments (for instance with infrastructure bonds) and to reduce vulnerability to high debt-equity gaps and interest rates volatility;
- focus on stakeholder consultation, local ownership and end-user involvement.

How to unleash Thailand's investment potentials with Public-Private Partnership

Somchai Jitsuchon, TDRI, Thailand

Somchai Jitsuchon explained that since the 1997 economic crisis, Thailand's public investment in infrastructure lags behind other Asian countries. However, new public investment would add pressure on debt. He suggested the following recommendations to set PPPs:

- Separating politics from investment, creating an independent PPP board;
- Drafting a PPP Master Plan for medium- and long-term strategy;
- Creating a special fast track procedure for urgent PPP needs;
- Beyond infrastructure PPP, introduce social PPPs to provide welfare.

Infrastructure Financing in LDCs and Emerging Economies: Risk Mitigation and PPPs

Martin Grandes, UCA, Argentina

- Because of market failures, private investment in developing countries is sub-optimal. International and domestic capital markets are largely inaccessible. But developing countries need deep and liquid financial markets.
- Public policies and development finance institutions (DFIs) can catalyse private funding by offering attractive risk mitigation products. These risk mitigation products will help crowding in the private investment and leverage this funding source.
- The risk mitigation tools need to meet the specific needs of each country and project. Possible instruments include:
 - loss guarantees, to reinforce interest from institutional investors;
 - multilateral credit insurance (monolines);
 - products targeted to regulatory and currency risks;
 - multilateral securitisation facility (to diversify the risk of a portfolio);
 - inclusion in ODA targets (to encourage bilateral agencies to expend their application);
 - Global Development Bonds (a fixed-income securitised product, to mobilise capital in a systematic manner).

Summarising the messages from the day

Burcu Hacibedel, OECD Development Centre

The meeting addressed cross-country and cross-sector evidence on how efficient and effective public spending on infrastructure could boost growth, achieve long lasting development and enhance the revenue raising potential in the developing world in the years to come. The message was simple – no one size fits all.

First, the assembly discussed the importance of infrastructure for enhancing competitiveness and ensuring social cohesion, whereby the market failures must be tackled by governments. Next, we focused on public sector capacity to allocate into infrastructure projects the funds from the available resources, and getting the private sector involved in project co-financing.

Following four issues arose:

- Funding gap and sustainability of infrastructure investment – Infrastructure projects are large-scale, costly and low-returns undertakings, difficult to deal with for governments faced with volatile revenues. Such revenues come either from public sources (e.g. tax revenues), or private engagements (e.g. PPPs) which are complement - and not substitute - to public involvement. The concern is not only financing but also the supply of know-how on project management.
- Capacity building – First, at sub-national level, clear regulatory frameworks must be enforceable and institutions in place to ensure infrastructure investment and project execution. Second, relevant human capital must be present, both within government institutions to undertake and monitor the projects, as well as in the case of outside parties providing assessment and evaluation.
- Ownership – Institutional mapping is important to establish who takes care of specific parts of infrastructure projects.
- Political economy of infrastructure policy – It should not be ignored and could be part of alternative models in addition to more conventional microeconomic frameworks.²

Three outstanding questions remain:

- How to establish priorities between infrastructure needs? There is certainly a need for effective communication between policy areas, and consultations with external stakeholders and society.
- What is gained at the macro level from infrastructure investment? Is it employment, financial market development or improvement in debt position, for example?
- (What are pros and cons of alternative sources for infrastructure investment, such as PPPs, SWFs, pension funds or infrastructure bonds, just to mention a few?)

² Thanks Prof. Alagh for this comment.