International Seminar on

Strengthening Public Investment and Managing Fiscal Risks from Public-Private Partnerships

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High-Level Seminar on "Strengthening Public Investment and Managing Fiscal Risks from Public-Private Partnerships", Budapest, 7-8 March 2007

Session 1: Public Investment and Fiscal Policy

Comments by Christophe Kamps, Senior Economist, European Central Bank[1]

The five papers in this session give a very comprehensive and accurate account of what we know and do not know about the macroeconomic effects of public investment. As there is little I can add to this detailed picture, I will focus my discussion on three (interrelated) aspects which in my view deserve particular attention.

First, I will argue that, from a researcher's perspective, the lack of detailed data on public capital stocks for many countries is the main impediment to learning more about the (non-)existence of public infrastructure capital gaps. Second, from a policymaker's perspective, one of the main issues is whether public investment should be a top priority on the government's agenda. This, of course, among other things, depends on the results of theoretical and empirical research on the relative productivity of alternative government spending items. Third, from a central banker's perspective, the impact of government decisions on the long-run sustainability of public finances is of particular importance. Many speakers at this conference have emphasized the challenges for fiscal surveillance and the risks for fiscal sustainability arising from the off-balance sheet treatment of most public-private partnerships (PPPs) in the current System of National Accounts. I fully agree.

Let me first turn to the *data issues*. Given the many voices to be heard that there are severe public capital gaps in many countries it may come as a surprise that for most countries, including most of the EU countries, there is little or no information on the aggregate level of public capital stocks. How can we then be so sure that there is a lack of public capital in these countries? The decline in public investment to GDP ratios over the past decades—often taken as an indicator for increasing public capital gaps—may be misleading, because this trend may simply reflect a gradual normalization after a period of exceptionally strong public investment in the aftermath of World War II. Another important issue is that there is a lack of data on disaggregated public investment. While empirical evidence indicates that public investment is productive, this is not necessarily true for all public investment spending. Public investment as recorded in the national accounts includes recreational items such as spending on museums and swimming pools, which cannot be regarded as enhancing productivity (unless relaxation would support productivity). Indeed, according to calculations of the European Investment Bank presented by Eric Perée only about half of public investment in EU countries is devoted to infrastructure provision. Moreover, as highlighted by several speakers, large parts of government spending on maintenance of existing infrastructure as well as spending on education and on research and development are recorded as current spending in the national accounts, even though from an economic point of view (given their assumed

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productivity-enhancing character) they could be regarded as investment spending. To sum up, there seems to be a clear need for more and better data on the level and composition of public capital stocks and for a reconsideration of the definition of public investment (at least if productivity enhancement was the main classification criterion).

Let me now turn to the issue of *policy priorities*, which is closely linked to the first point. On the one hand, it is important to know whether there actually is a lack of public capital and, if so, in which areas. On the other hand, it is important to know whether it would be better to allocate government resources to additional public investment or to other, potentially more productive types of government spending. Indeed, there is ample empirical evidence suggesting that human and knowledge capital accumulation are important drivers of economic growth and most likely more important than (public) physical capital accumulation. In this respect, it is interesting to note that the new EU member states, which are often said to exhibit very large infrastructure gaps, spend much more on public investment in relation to GDP than the average EU country, while they spend considerably less on education as well as on research and development. It is, thus, far from obvious that public investment should be the top priority on the government agenda at the current juncture. And even if there were a need for more infrastructure capital, there is still the open question whether the private sector could not (partly) provide the necessary investments more efficiently.

Let me therefore finally turn to the *challenges for fiscal surveillance and long-run fiscal sustainability* arising from the increased recourse to public-private partnerships (PPPs) as a means of providing infrastructure assets. As emphasized by the speakers at this conference there are three main reasons for using PPPs for this purpose. First, the private sector is likely to be more efficient than the public sector because of its superior management capabilities. Second, PPPs are likely to be more successful than outright privatisation because of the public good nature of many infrastructure services. Third, the recourse to private financing enables governments to carry out infrastructure projects without having to finance the total amount of investment at once. Unfortunately, past experience shows that governments in some countries, while recognising their inherent economic benefits, have used PPPs mainly to move investment projects off the government balance sheet. In this respect, the current treatment of PPPs in the System of National Accounts creates incentives for governments to record PPP projects off-balance sheet and to circumvent national and international budget rules, even if there is no value for money in carrying out a project under a PPP instead of resorting to traditional public procurement. In particular, the guarantees given to the private sector under PPPs create contingent government liabilities, which are not reported in the government accounts under the current System of National Accounts. Moreover, many countries, with the notable exception of the United Kingdom, do not disclose information on the amount of contingent liabilities associated with PPP projects. This creates both important challenges for fiscal surveillance and substantial risks for long-run fiscal sustainability. Given that many governments plan to considerably extend the scope for PPPs in the coming years, there is a clear need for close monitoring of PPP developments especially in EU countries in order to avoid that they assume an excessive amount of contingent liabilities.