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## Executive Summary

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*Between 2008 and 2011, most OECD member countries have rapidly switched from expansive fiscal policies to the tightest ones in decades*

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OECD member countries and regions currently face a narrow path to long-term growth. As stimulus packages are phased out, the priority of many OECD member countries is to restore fiscal sustainability. In 2011, gross government debt is expected to exceed 100% of GDP in the OECD area, with some countries moving well beyond this figure. After the stimulation period of 2008-09, public investment is now a target of cuts in many countries and regions, and seems in some cases to be used as the adjustment variable. Faced with the challenge of supporting growth in such a tight fiscal environment, national and sub-national governments face the imperative of “doing better with less.”

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*Sub-national governments have had a critical role to implement investment recovery strategies*

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During the crisis and subsequent recession, many OECD and G20 countries implemented stimulus packages, which in some cases amounted to 4% or more of GDP (Australia, Canada, Korea, United States). On the expenditure side, the fiscal programmes typically focused on public investment. Given their large traditional role in public investment in OECD countries, sub-national governments (SNGs) have played an important role in implementing investment recovery strategies as part of national stimulus packages recovery measures. SNGs are responsible on average for 66% of OECD investment spending. Some countries specifically targeted their fiscal recovery packages towards sustaining public investment for SNGs. For example, one-quarter of investment funds have been administered by *Länder* in Germany, one-third of the stimulus package has been managed by states in the United States, half of the investment funding in Australia has been implemented by sub-national actors, and around 75% in Korea and Spain.

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*Implementing both timely and well-targeted investments is challenging*

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Investment strategies launched during the recession had a difficult path to take: they have to be, like other stimulus measures, timely, temporary and targeted. They had to be implemented quickly, correspond to strategic priorities and be transparent and subject to rigorous scrutiny. These dimensions are difficult to reconcile. In addition, public investment plans had an inherent tension between the short term and the long term. The economic and political context called for short-term measures with the highest impact on employment, but these may not necessarily be the most appropriate over the long term.

Overall, the focus has been on spreading resources across the territory rather than targeting for territorial impact. In a context of nationally launched strategies, priorities

have been built vertically along existing sectors and programmes; and there has been little differentiation among territories in terms of allocation of funds. National governments have focused mostly on sectoral priorities for investment, in particular infrastructure (roads, railways, ICT, public transports, schools). Many countries have also sought a balance with “soft” investment, in particular to support R&D and innovation, green technologies, and investment in human capital.

Investment strategies have sought in priority “shovel-ready” infrastructure projects, i.e. projects well advanced in planning and ready to be launched. However, not all countries and regions were able to mobilise shovel-ready projects that were compatible with the level of stimulus spending available or with the conditions set for its use; and different types of implementation challenges have been met across levels of government.

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*The emphasis on speed in committing funds, although understandable as a goal, has probably overshadowed planning for maximum economic impact*

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By the end of 2010, most countries had already *allocated* more than 90% of the funds, in part through local governments (Australia, Canada, Germany, France, Korea, Spain, United States). Actual *spending* has been slower, however, and there have been significant variations across policy areas. Requirements for the use of funding have had a strong influence on the type of projects selected by sub-national governments. Most investment strategies have set specific conditions and a time frame for the use of funds. Speed has mainly determined the selection of investment projects. Micro-scale short-term infrastructure projects conducted at the municipal level could easily meet the criteria for eligibility.

The emphasis on speed in committing funds, although understandable as a goal, has probably overshadowed planning for maximum economic impact. Indeed, recent OECD analysis (OECD, 2008) has shown that the complementarities across the different types of investment in a place-based approach, are essential; since infrastructure investment *alone* has little impact on regional growth. If a region is to benefit from a new road, school or any other type of public investment, certain conditions in terms of complementary local infrastructure or services need to be fulfilled. Since this co-ordination does not take place spontaneously, multi-level governance (MLG) arrangements are needed to promote effective co-ordination across programmes and levels of government.

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*The crisis crystallised multi-level governance challenges*

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Four challenges have been particularly important across levels of government when implementing investment strategies across levels of government: i) the fiscal challenge, and the difficulty of co-financing investment; ii) the capacity challenge, linked to inadequate resources, staffing or processes for rapid, efficient and transparent implementation of investment funding; iii) the policy challenge, and the difficulty of exploiting synergies across different sectors and policy fields; and iv) the administrative challenge, and the fragmentation of investment projects at the local/municipal level. These different types of challenges could make the implementation of investment schemes difficult, or could lead to unintended consequences, ultimately potentially undermining the impact of the plans. The extent to which countries have faced these challenges varies. For example, the fiscal gap has been greater in the United States than in other countries. The administrative gap tends to be higher in countries with municipal

fragmentation, such as France or Spain. There are also important variations *within* countries on the extent to which different challenges were met. This is also linked to the fact that the impact of the crisis has varied significantly across regions.

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*Appropriate co-ordination across levels of government has proven critical for facilitating the implementation process, targeting investment priorities and ensuring coherence in policy objectives*

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Co-ordination across levels of government and multi-level governance instruments have helped overcome these challenges and target both short-term and long-term development objectives. While some countries were able to mobilise existing co-ordination mechanisms, others had to create them in the midst of the crisis. For example, the responsiveness of the Australian government during the crisis was helped by the presence of a well-developed multi-level governance body, the Council of Australian Governments (COAG), which provided a forum for decision making and prioritisation of investment. In Sweden, “regional co-ordinators” were created to co-ordinate policies and resources from different levels of government. In the United States, both the federal government and states have created new institutions to co-ordinate the federal, state and agency levels. Horizontal co-ordination across jurisdictions has also been essential to target effectively the relevant scale for investment. In Germany for example, implementation of the sub-national investment package was entirely decentralised and there were some good practices of inter-municipal co-operation, for example in Nordrhein-Westfalen where an agreement was reached across municipalities for the allocation of funds.

In responding to the crisis, regional policy and related governance instruments have also been valuable for prioritising investment and exploiting complementarities across programmes. In France, for example, regional policy tools such as inter-governmental contractual agreements helped to identify better targets quickly and to channel new central investment funding more effectively. Regional development strategies, defined for the EU Cohesion Policy, have been mobilised in several European countries to speed up decision making for the allocation of investment.

Overall, the effectiveness of recovery strategies based on public investment depends largely on the arrangements between levels of government to design and implement the investment mix. They are critical in particular to bridge the policy and financial gaps across levels of government, enhance complementarities across programmes, facilitate public-private co-operation and foster transparency in the use of funding at all levels. To facilitate co-operation across levels of governments with private actors, countries simplified administrative procedures for approving and disbursing funds to speed up the implementation of projects. Some OECD member countries accelerated their public procurement procedures (France, Korea). To limit risks of capture and respond to demand for transparency in the use of funding, new governance approaches were developed to better monitor the use of funding.

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*The crisis also provides an opportunity for public management reforms which can have lasting positive effects, such as better monitoring of investment performance and greater government responsiveness*

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A notable feature in particular has been the improvement in the transparency and performance monitoring in the use of investment funding. Monitoring the use of funds has gone well beyond traditional audit control, as a central objective in most countries was to provide citizens and private firms with as much transparency and information as possible. Technology and e-government tools have been used in an unprecedented manner. Many countries and regions have created websites that enable citizens to track stimulus packages and other public funds committed to addressing the crisis, often with detailed territorial information on where the money is being spent (for example in Australia, Canada, France, Germany, United States). Given the traditional difficulty of tracking investment funding at the local level, this constitutes a significant shift towards better practices.

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*Just as co-ordination between levels of government was important to implement recovery measures, multi-level governance mechanisms are necessary to manage fiscal consolidation and reduced public investment*

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As stimulus packages are phased out, many countries (and SNGs) are planning some combination of tax increases and spending cuts in 2011 and beyond and public investment is particularly targeted as an adjustment variable at all levels of government. Policy co-ordination, transparency and information sharing across levels of government are equally crucial during the consolidation as during the management of the stimulus. It is all the more important to enforce strategies since budget cuts are by nature more difficult to implement than budget increases.

Multi-level governance challenges may in fact be amplified in the current context if appropriate co-ordination measures are not mobilised and if the focus is only on the short term. Urgency is also a key dimension of fiscal consolidation, given the scale of deficits and the pressure of financial markets. More than 70% of total consolidation efforts will take place between 2011 and 2012 (OECD, 2011a). Not only the fiscal gap, but also the policy and information gaps run significant risks of worsening if appropriate co-ordination efforts are not mobilised at all levels of government.

Risks include a *cascading effect*, where each level of government transmits the reduction in their budgets to lower levels of government. Other risks include the development of a one-size-fits-all fiscal consolidation strategy for all territories (although fiscal and economic challenges vary considerably across regions) and across-the-board cuts in capital expenditures at the sub-national level, without distinguishing the degree of priority of programmes. To avoid simply shifting the problem from the centre to the regions, co-ordinated efforts from all levels of government are required to accommodate appropriate budget cuts for fiscal consolidation and better prioritise investment in what unlocks each region's potential to restore growth.

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*Guidelines for designing and implementing public investment strategies across levels of government*

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In a context where the room for manoeuvre is highly constrained, it is even more important to make the most of public investment. Learning from the crisis and the different challenges met by countries and SNGs, one can identify a common set of guidelines for the design and implementation of public investment strategies across levels of government:

**1. Combine investments in physical infrastructure with investments in soft infrastructure**, such as human capital and other innovation-related assets, to maximise impact in terms of long-term productivity growth.

**2. Exploit the value added of *place-based* investment policies.** Investment should be prioritised to address the specific potential and impediments to growth in each region. Clarify the social or growth objectives of investment projects and for the latter, favour selection of projects through competitive procedures.

**3. Improve co-ordination mechanisms for the design and implementation of investment strategies across levels of government.** The management of the crisis has shown that co-ordination is critical for designing well-informed investment strategies, better targeting them and ensuring policy and fiscal coherence across levels of government. Co-ordination takes time, involves a learning curve and has different types of costs, but when properly designed and implemented, long-term benefits of co-ordination should largely outweigh its costs.

**4. Enhance horizontal co-ordination across local jurisdictions** (in particular municipalities) to achieve greater critical mass at functional level and increase economies of scale in investment projects.

**5. Build transparent management process to improve the selection and implementation of investment projects at all levels of government.** Given the complexity of investment decisions and their governance, oversight institutional mechanisms need to be well developed not only for the audit function but also for the relevance of investment choices.

**6. Address risks associated to long term investment commitments through robust budget procedures.** Cost-benefit analysis and strategic environmental analysis should be mobilised to help inform and select investment projects. Operational costs of the maintenance of investment over the long-term should be fully assessed from an early stage in the decision-making process.

**7. Diversify sources of financing for infrastructure investment**, by making more and better use of user fees and creating mechanisms for securing long-term financing for infrastructure. Carefully assess the benefits of public-private partnerships (PPPs), as compared to traditional procurement. Consider setting up joint investment pools across public agencies/ministries, to help prioritise investment.

**8. Conduct regular reviews of the regulation with potential impact on public investment decisions and strengthen regulatory coherence across different levels of government.** Contradictory regulations across government levels, as well as obsolete and excessive regulations, may impede public investment.

**9. Focus on capacity building at all levels of government.** Investment projects may fail or engender significant waste or corruption in the absence of adequate or sufficient support services and credible leadership.

**10. Bridge information gaps across levels of government.** Pursue the efforts made during the crisis to enhance the use of e-government tools for performance monitoring of investment funding and the access of citizens, private firms and government services to shared databases.