Making the Most of Public Investment in a Tight Fiscal Environment

MULTI-LEVEL GOVERNANCE LESSONS FROM THE CRISIS



OECD

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Foreword

How to make the most of public investment? This question is critical in today's tight fiscal environment. Given that sub-national governments in OECD countries carry out more than two-thirds of total capital investment, they have a crucial role to play in this area. In order to identify good practices for governance of public investment across levels of government, the report focuses on lessons that can be extracted from the management of stimulus packages during the global crisis in 2008-09. Indeed, these strategies were largely based on public investment, and sub-national governments played a key role in executing them.

This report provides an overview of challenges met in the recovery and highlights good practices and lessons learned in a multi-level governance perspective, focusing on eight country cases: Australia, Canada, France, Germany, Korea, Spain, Sweden and the United States. These countries all targeted similar objectives – to implement recovery schemes in a timely, targeted and temporary manner – and addressed common implementation challenges, although their institutional frameworks vary greatly. The report shows that 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. As stimulus packages are phased out, and countries pursue fiscal consolidation, there is a risk that long-term public investment, a basis for future economic growth, will be sacrificed to short-term budgetary pressures. Co-ordination between levels of government was essential to implement recovery measures during the crisis; it is at least as important in the context of fiscal consolidation, as governments struggle to make the most of limited investment resources for sustainable growth.

This publication draws on multiple sources of information. It relies primarily on the country case studies, which were developed in 2010. It draws on work carried out by the OECD Territorial Development Policy Committee (TDPC) and its related networks, in particular: work developed by the OECD Network on Fiscal Relations across Levels of Government on the impact of the crisis on sub-central finances; and by the Working Party on Territorial Indicators on public investment in regions. Other work developed by the Public Governance and Territorial Development Directorate on fiscal consolidation has also been a useful source of information, as well as work developed by the OECD Economics Department (ECO) and the Science, Technology and Industry Directorate (STI).

This work contributes to the body of research on multi-level governance and regional development elaborated by the Regional Development Policy Division (RDP) of the OECD Directorate for Public Governance and Territorial Development. Recent work on these issues includes the *Regional Outlook* (forthcoming, 2011); *Multi-Level Governance of Water Policy* (forthcoming, 2011); *Regions Matter* (2010); *Governing Regional Development Policy: The Use of Performance Indicators* (2009); *Linking Regions and Central Governments: Contracts for Regional Development* (2007); as well as the series of national and regional *Territorial Reviews*.

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This report was written and co-ordinated by Dorothée Allain-Dupré, from the Regional Development Policy Division (RDP) of the Public Governance and Territorial Development Directorate. It was elaborated under the direction of Claire Charbit, Head of the Multi-Level Governance unit and Joaquim Oliveira Martins, Head of Regional Development Policy Division. Substantial contributions on country cases were provided by Hanna Kleider. Valuable comments and inputs were also received from Ashley Santner, Camila Vammalle, William Tompson, Aziza Akhmouch, Soo-Jin Kim, Monica Brezzi, and Karen Maguire of the OECD Secretariat. Statistical analysis was provided by Mauro Migotto. Doranne Lecercle provided assistance for editing the report. Jennifer Allain and Jeanette Duboys prepared the report for publication.

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- **Australia:** Sue Vroombout, Paul Kennelly and Linda Ward, National Treasury.
- **Canada:** Richard Cormier and Paul Leblanc, Atlantic Canada Opportunities Agency (ACOA); Adam Ostry, Infrastructure Canada; Finance Canada.
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- **Sweden:** Sverker Lindblad, Hanna Wiik and Anna Olofsson, Ministry for Energy, Enterprise and Communication.
- **United States:** Frank DiGiammarino, Recovery Implementation Office, White House; Tobin Marcus, Office of the Vice-President.

Table of contents

Executive Summary 9

Part I Comparative overview: challenges and lessons 15

Introduction 17
I.1. A critical role for sub-national governments during the recovery 17
I.2 Managing investment across levels of government: key challenges 25
I.3. Overcoming obstacles to implementation: the need for co-ordination 38
I.4. Making the most of public investment in times of austerity 54
Notes 66
Bibliography 75

Part II Country cases 81

Chapter 1. **Australia** 83

Macro dimension 84
Design of the public investment measures 85
Implementation of the public investment scheme 89
Obstacles and co-ordination challenges across levels of government – lessons learned? 91
Notes 94
Bibliography 96

Chapter 2. **Canada** 97

Macro dimension 98
Design of the public investment scheme 101
Implementation of the public investment scheme 104
Main obstacles and co-ordination challenges across levels of government – lessons learned? 106
Notes 108
Bibliography 110

Chapter 3 **France** 111

Macro dimension 112
Design of the public investment scheme 112
Implementation of the public investment scheme 114
Obstacles and co-ordination challenges across levels of government – lessons learned? 120
Notes 123
Bibliography 125

Chapter 4. **Germany** 127

Macro dimension 128
Design of the public investment scheme 130
Implementation of the public investment scheme 132
Main obstacles and co-ordination challenges across levels of government – lessons learned? 133
Lessons learned 134
Notes 135
Bibliography 136

Chapter 5. **Korea** 137

Macro dimension 138
Design of the public investment scheme 141
Implementation of the public investment scheme 144
Main obstacles and co-ordination challenges across levels of government – lessons learned? 144
Notes 147
Bibliography 147

Chapter 6. **Spain** 149

Macro dimension 150
Design of the public investment measures 151
Implementation of the public investment scheme 152
Main obstacles and co-ordination challenges across levels of government 153
Notes 156
Bibliography 156

Chapter 7. **Sweden** 159

Macro dimension 160
Design of the public investment scheme 161
Implementation of the public investment scheme 164
Main obstacles and co-ordination challenges across levels of government – lessons learned? 164
Notes 167
Bibliography 169

Chapter 8. **United States** 171

Macro dimension 172
Design of the public investment scheme 175
Implementation of the public investment scheme 178
Obstacles and co-ordination challenges across levels of government – lessons learned? 180
Notes 186
Bibliography 197

Tables

Table I.1. Measures adopted by central governments to support sub-national public investment 24
Table I.2. Targeted policy areas/territories for investment funding during the crisis 27
Table I.3. Total investment funding allocated across levels of government by September 2010 30
Table I.4. Mutual dependence across levels of government: multi-level governance challenges/gaps in OECD member countries 32
Table I.5. Challenges of excessive centralisation or decentralisation in implementing national investment strategies 38
Table I.6. Reduced central government financial support to sub-national governments 57
Table 1.1. Targeted sectors in the national investment recovery strategy 86
Table 1.2. Planned implementation of investment 89
Table 5.1. Fiscal stimulus in Korea 140
Table 5.2. The Five-Year Plan for Green Growth (2009-13) 142
Table 5.3. PPPs and financial subsidies by level of government and type of project 143
Table 5.4. Type of investment selected in priority 144
Table 7.1. Implementation of investment projects of the national investment package launched during the crisis 164

Figures

Figure I.1. Gross fixed capital formation 18
Figure I.2. Gross fixed capital formation (OECD average) 19
Figure I.3. SNGs as a share of total public investment, 2008 19
Figure I.4. SNGs' capital expenditure as a % of GDP, 2009 20
Figure I.5. Trade-off between short- and long-term objectives 26
Figure I.6. Sub-national government capital expenditures as percentage of GDP 2009 compared to 2007 31
Figure I.7. Fiscal consolidation strategies in OECD member countries: frequency of major programme measures 55
Figure I.8. State budget shortfalls in the United States (March 2011) 56
Figure 2.1. Value of projects under the Infrastructure Stimulus Fund by sector 100
Figure 4.1. Distribution of investment funds per level of government 129
Figure 4.2. Distribution of investment funding per *Land* 131
Figure 5.1. Number of construction orders received by type of order 143
Figure 8.1. Breakdown of ARRA stimulus measures 173
Figure 8.2. Sectoral composition of the ARRA stimulus package of 2009 174
Figure 8.3. Composition of state and local Recovery Act funding, FY2009 and FY2010 through 2019 estimated 179
Figure 8.4. States' and localities' uses of funds in 16 selected states 180
Figure 8.5. US city spending cuts in 2009 181

Boxes

Box I.1. How do regions grow? 21
Box I.2. Stimulus plans in OECD member countries in 2008-09 22
Box I.3. Green measures in investment stimulus packages 22
Box I.4. OECD approach to multi-level governance challenges 32

Box I.5. Main obstacles and co-ordination challenges or gaps in the implementation of investment strategies across levels of government (September 2010) 33
Box I.6. Performance monitoring for investment projects financed by the Department of Transportation (DOT) in the United States under ARRA 37
Box I.7. Co-ordination across levels of government during the crisis: answers to the OECD questionnaire to European state territorial representatives 39
Box I.8. Defining "co-ordination" 40
Box I.9. How to limit costs and maximise benefits of co-ordination? 41
Box I.10. The role of the COAG in Australia in the governance of the crisis 42
Box I.11. Cohesion policy in the European Union Recovery Plan 44
Box I.12. Anti-crisis tools: acceleration of national investment strategies in Canada and Brazil, with well-defined MLG arrangements 46
Box I.13. The increased use of PPPs during the crisis 49
Box I.14. The use of Public Private Partnerships (PPPs) at sub-national government level: the need for prudence 50
Box I.15. New budgeting practices for monitoring the use of funds under Australia's recovery plan 52
Box I.16. Government websites with detailed territorial information on the use of funds 53
Box I.17. Fiscal consolidation strategies at the national government level in OECD member countries 55
Box I.18. Examples of multi-level governance reforms adopted in OECD member countries in the wake of the crisis 61
Box I.19. Overview of current investment strategies in selected OECD and G20 countries (in September 2010) 62
Box 1.1. The Australian Federation and COAG co-ordination 86
Box 1.2. District of Heathcote 89
Box 1.3. Infrastructure Australia 93
Box 2.1. The 2007-14 Building Canada Plan 100
Box 3.1. The FCTVA 113
Box 3.2. The interface between the central and local levels in France 115
Box 3.3. The state-region project contracts (CPER) 116
Box 3.4. Summary of the recovery plan's results as of 3 August 2010 118
Box 3.5. The role of local governments and prefects in implementing the FCTVA 119
Box 4.1. Implementing the investment package: the case of Nordrhein-Westfalen 132
Box 6.1. Asymmetric decentralisation in Spain 155
Box 7.1. Institutional framework and asymmetric regionalisation process in Sweden 163
Box 8.1. Objectives of the American Recovery and Reinvestment Act (13 February 2009) 173

Executive Summary

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

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."

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

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.

Implementing both timely and well-targeted investments is challenging

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.

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

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.

The crisis crystallised multi-level governance challenges

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.

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

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.

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

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.

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

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.

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

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.

Part I

Comparative overview: challenges and lessons

Given that sub-national governments in OECD countries carry out more than two-thirds of total capital investment, they have played a key role in executing national stimulus packages during the global crisis. The effectiveness of recovery strategies based on public investment thus depends largely on the arrangements between levels of government to design and implement the investment mix, in particular to bridge the policy and financial gaps across levels of government, facilitate public-private co-operation and enhance transparency and accountability in the use of funding at all levels. Part I of the report highlights good practices and lessons learned, focusing more extensively on country examples developed in the second part of the report, i.e. Australia, Canada, France, Germany, Korea, Spain, Sweden and the United States. As stimulus packages are phased out, many countries have moved toward fiscal consolidation and public investment is particularly targeted as an adjustment variable. Just as co-ordination between levels of government was important to implement recovery measures, multi-level governance arrangements and place-based approaches are necessary to better prioritise reduced public investment and make the most of it.

Introduction

OECD member countries and regions currently face a narrow path to long-term growth given uncertainty in the global finance system, instability in sovereign debt markets, pressure on public sector budgets, and persistently high levels of unemployment. At the end of 2010, 50 million people were still unemployed in OECD member countries. The right policy mix and trade-offs are difficult, and there are no easy solutions. The current economic situation is evolving rapidly and calls for agility in policy action. The priority of many OECD member countries is to restore fiscal sustainability and trust. In 2011, gross government debt is expected to exceed 100% of GDP in the OECD area, with some countries moving well beyond this figure.

At the same time, it is crucial to secure long-term growth through appropriate investment, in particular for innovation and green growth. Sufficient "fiscal space" for key public expenditure programmes that support economic development, including public investment, is important, even when government budgets are tight (OECD, 2010d). Given that sub-national governments (SNGs) in OECD member countries make more than two-thirds of all capital investment, investing for growth depends crucially on actions taken at the regional and local levels. This shows the need for proper co-ordination across levels of government.

Over 2008-11, most OECD member countries switched from highly expansive fiscal policies, sometimes with a renewed focus on public investment, to the tightest ones in decades. Countries and regions therefore have to make the most of public investment. Many OECD and G20 countries implemented strategies to invest in infrastructure as part of their 2008-09 stimulus packages. Although the strategies were designed at the national level, sub-national governments played a key role in implementing. For future investment strategies it is important to learn about obstacles encountered across levels of government and the instruments that facilitated implementation during this turbulent period.

This publication first explores the renewed role of public investment during the crisis and the key role played by SNGs. It then looks at the degree to which investment strategies were implemented and the various challenges faced. The governance instruments mobilised or set up to overcome these difficulties are then discussed. The fourth section focuses on the current context of fiscal consolidation and seeks to identify guidelines for the governance of public investment.

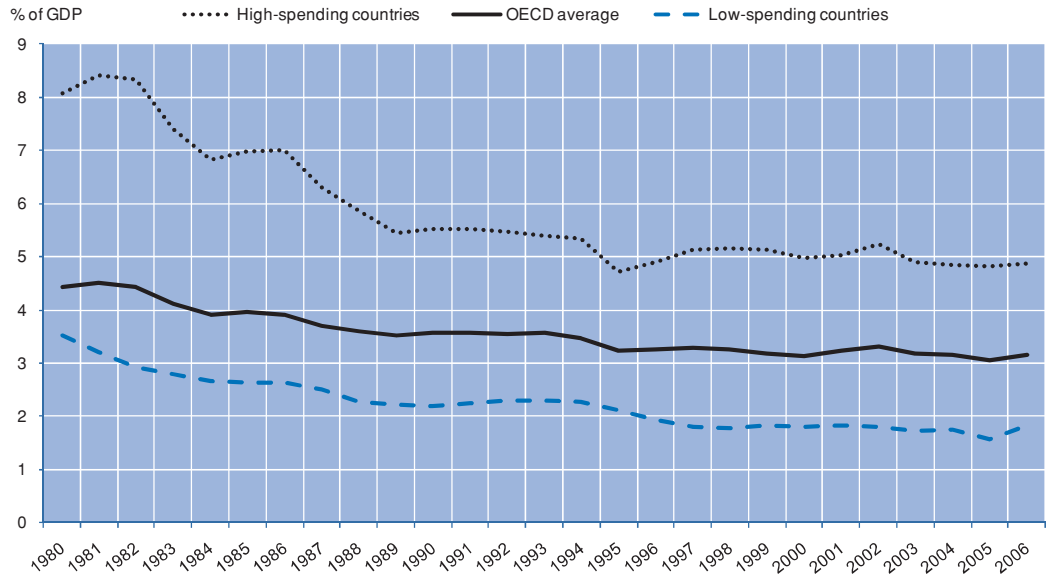
I.1. A critical role for sub-national governments during the recovery

Relative decline of public investment in OECD member countries in the past decades

Since the early 1980s, public investment had slightly declined as a share of GDP in OECD countries (Figure I.1). The decline was more pronounced in countries such as Japan, Austria and Switzerland. Generally, the rate of gross fixed capital formation (GFCF) in the energy and water supply sectors has declined continuously since the 1970s, falling on average from around 1.5% of overall GDP to below 1% of GDP (Sutherland *et al.*, 2009). Over the past two decades, the investment rate has been falling in energy, water and transport in most OECD countries. More recently, investment in the telecommunication sector has been growing rapidly in all OECD countries (ibid, 2009).

These trends reflect a decrease in infrastructure investment, as most OECD countries already have well-developed infrastructure and now focus on maintenance. They also reflect a change in investment from infrastructure to intangibles.[1]

Figure I.1. **Gross fixed capital formation**

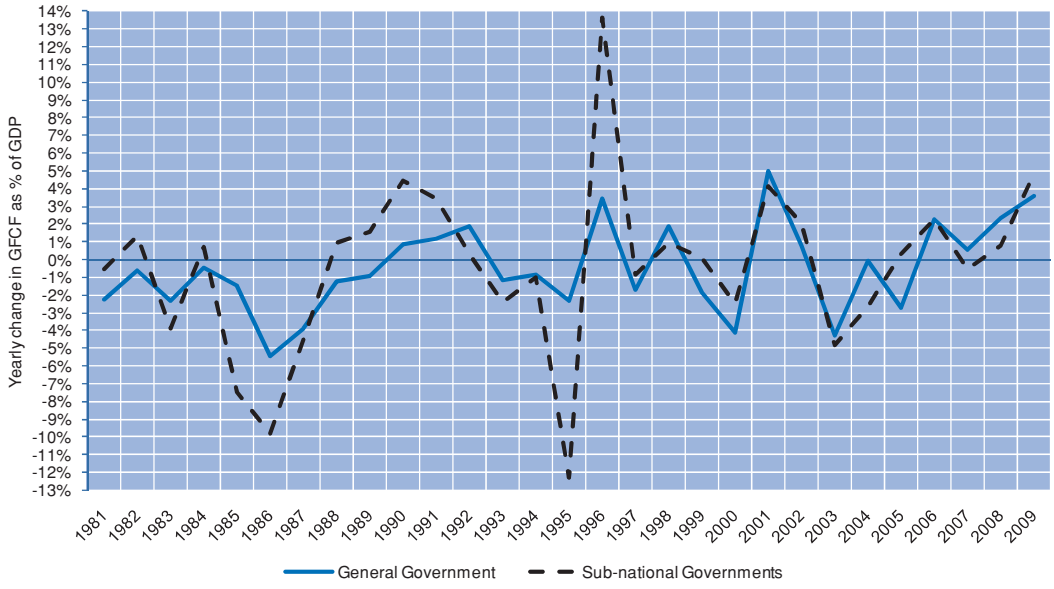


Notes: 1. The series for high and low public spending are the means of public gross fixed capital formation as a share for GDP for five countries, which on average over the period had the highest or lowest public investment rates. The high-spending countries are Japan, Korea, Mexico, New Zealand and Turkey. The low spending countries are Australia, Belgium, Denmark, Germany and the United Kingdom. 2. It is difficult to compare the rate of public sector investment across countries, given differences in the scope of governments.

Source: OECD National Accounts in Sutherland, D. *et al.* (2009), "Infrastructure Investment: Links to Growth and the Role of Public Policies", *OECD Economics Department Working Papers*, No. 686, OECD Publishing. Paris.

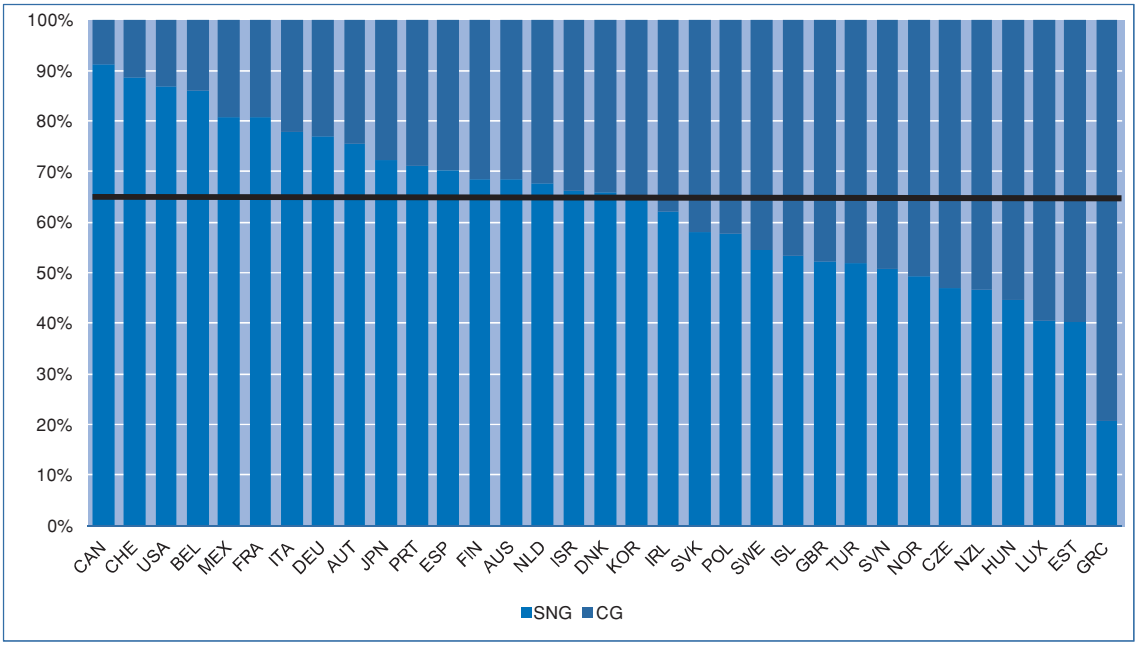
Compared with national government investment trends, the decline of capital expenditure[2] at sub-national level has been more limited. However, public investment[3] was more volatile in sub-national governments than in the general government, at least until the mid-1990's (Figure I.2). SNGs play a critical role in public investment in OECD member countries, as they are responsible on average for 66% of OECD gross fixed capital formation spending[4] (Figure I.3) and around half of total capital expenditure.[5] As an order of magnitude, this represented 2.4% of OECD GDP in 2009, higher than average OECD research and development (R&D) expenditures (2.3%) or equivalent to total public and private OECD expenditures for primary and lower secondary education. Spain, Korea, Poland and Ireland have the highest share of sub-national capital spending on GDP and Greece and Denmark the lowest. The amount of public investment per person also varies greatly among regions in the same country.[6] There are also significant variations among regions in the sectoral breakdown of sub-national capital expenditure (Annexes I.A1 and I.A2 provide more details for a limited sample of countries).

Figure I.2. **Gross fixed capital formation (OECD average)**



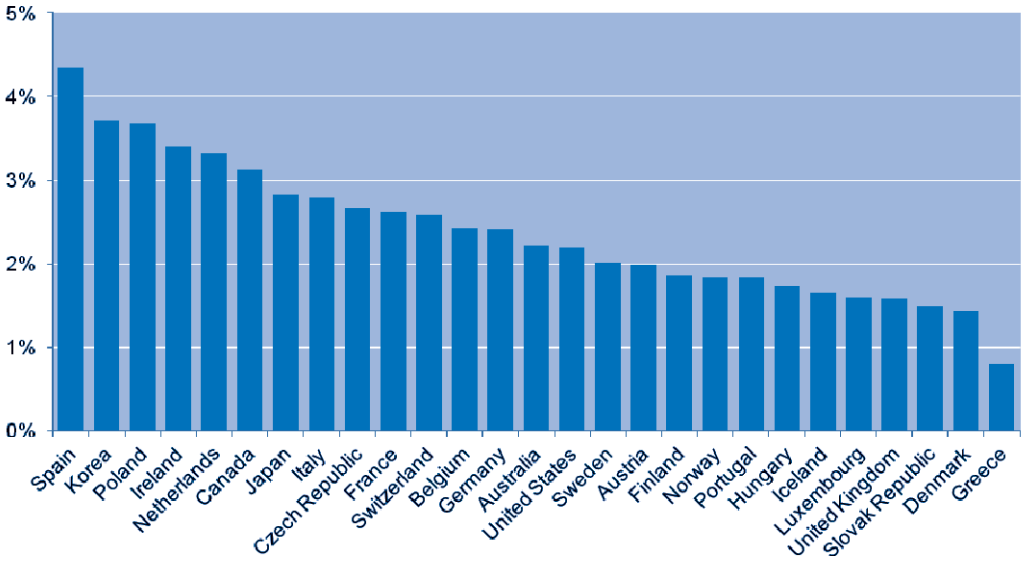
Source: OECD National Accounts (2009).

Figure I.3. **SNGs as a share of total public investment, 2008**



Source: OECD National Accounts (2008).

Figure I.4. **SNGs' capital expenditure as a % of GDP, 2009**



Note: 2007 data for Japan; 2008 data for Australia, Korea, Mexico and New Zealand.

Source: OECD National Accounts (2009).

Linking investment and growth: the role of regions

Although the impact of public investment on growth is difficult to measure,[7] the OECD has developed some evidence that infrastructure investment has positive effects that go beyond the expected impact from an increase in capital stock, and that public investment in both physical and intangible investment (such as R&D and education) can have a positive impact on long-term growth (OECD, 2009a; Padoan, 2010).

Recent analyses point out that infrastructure investment *alone* has little impact on regional growth unless it is associated with human capital and innovation (OECD, 2009p; see Box 1). Regional actors are often the best placed to identify local needs and exploit synergies across investment priorities. Given the heterogeneity of economic activities at the regional and local level, investment policies that are space-blind are likely to be ill-designed (Garcilazo and Oliveira Martins, 2010). Growth effects are likely to appear only when positive externalities exist in the region; otherwise the economic returns from investment may be negative. 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. Differentiated investment strategies are required to tailor investment to local needs and the competitive advantages of regions.

However, this co-ordination does not take place *spontaneously*. Multi-level governance (MLG) arrangements are required to encourage the design of the *differentiated* investment strategies, promote complementarities across sector programmes, as well as ensure coherence across levels of government. Sub-national governments can help to better target investment to local needs and to exploit complementarities across investment priorities. However, local capacity to design an appropriate investment mix must be sufficiently developed, the policy and institutional framework for investment must be robust and transparent so as to prevent potential

capture or corruption, and the scale of investment must be appropriate. These conditions will be further discussed in the following sections.

Box I.1. How do regions grow?

Infrastructure investment can be useless (or counter-productive) unless undertaken in conjunction with human capital and innovation policies. Evidence from econometric regressions suggests that:

- Human capital – mainly tertiary educational attainment – is the most robust factor and takes about three years to have an impact.
- Infrastructure has an impact as long as other factors are also in place such as human capital and innovation.
- Innovation has an impact on growth, but is a longer term process, taking from five to ten years.
- Agglomerations in services (measured by a region's specialisation index times size in financial intermediation) has a positive impact on growth.

Source: OECD (2009), *How Regions Grow: Trends and Analysis*, OECD Publishing, Paris, doi: 10.1787/9789264039469-en.

A renewed role for public investment during the crisis

The relative decline in public investment in OECD member countries at the national level over the past decades was reversed in some countries with the stimulus packages launched in 2008-09. In addition to many other government measures to avoid economic collapse such as major bailouts of banks and overall support to the financial sector, tax cuts and expansive monetary policies, the crisis sparked a renewed role for public investment in some countries (Box I.2). Public investment programmes amounted to 11.1% of public spending in 2008[8] and 9.3% of total public spending in 2009; this was equivalent to 4% of OECD GDP in 2009[9] (compared to 3.3% in 2006). The most proactive countries when it comes to public investment measures were Australia, Canada, Germany, Mexico, Korea, Poland, Spain and the United States. Denmark and France also have had a clear focus on public investment for their recovery strategies.

National governments have designed their investment strategies in a situation of urgency and have focused mostly on infrastructure. The targeted infrastructure investments are largely concerned with roads, railroads (including freight networks), public transport, airports, childcare facilities, schools and universities, hospitals, energy networks and security, and a modern information and communication technology (ICT) infrastructure (Guellec and Wunsch-Vincent, 2009). However, many countries have also sought a balance with "soft" investment, in particular in the following areas: *i)* support for science, R&D and innovation; *ii)* investment in human capital and education/training (including schools, teachers); *iii)* green technologies and innovations to foster energy-efficiency and sustainable economic growth; and *iv)* support for innovation and entrepreneurship (Guellec and Wunsch-Vincent, 2009).

Box I.2. **Stimulus plans in OECD member countries in 2008-09**

The crisis has had enormous economic, financial and social repercussions throughout the OECD, but also deep implications for public governance, increasing its legitimacy. The crisis has represented a "turning point" (Krugman, 2009) for the role of governments in the economy. Governments have in many countries helped to maintain citizens' confidence in the economy by playing the role of insurers and spenders of last resort, supporting the banking system and mobilising traditional instruments of direct intervention such as regulations, nationalisations (mainly banks) and public investment.

The global dimension of the 2008-09 crisis – in its impact and in governments' responses – is remarkable. Almost all countries in the OECD and in the G20 implemented fiscal stimulus measures for 2008-10. As a share of GDP, the size of the economic stimulus packages in OECD member countries ranges between 0.1% of 2008 GDP to over 5%, with an average of 2.5% (OECD, 2009a). Australia, Canada, Korea, New Zealand and the United States introduced fiscal packages amounting to 4% or more of 2008 GDP. Those of the United States at about 5.5% of 2008 GDP and of Korea were the largest. Countries with the largest absolute spending are the United States, Germany, Japan, Canada, Spain, Australia and Korea.

On the expenditure side, the fiscal programmes typically focused on infrastructure development and active labour market measures. On the revenue side, a reduction of the national tax burden, primarily personal income taxes, was planned.

Every form of stimulus has its drawbacks. As a general rule it is better to rely on complementary forms of stimulus rather than a single instrument such as a tax decrease or public investment. Most countries have adopted a balanced approach to stimulus packages.

Fiscal measures depend on the overall economic and fiscal status of the country. Countries such as Hungary, Iceland and Ireland drastically tightened their fiscal stance in 2009 (OECD, 2009a).

Source: Padoan, Pier Carlo (2009), "Fiscal Policy in the Crisis: Impact, Sustainability, and Long-Term Implications", *ADBI Working Papers Series*, No 178, December, Asian Development Bank Institute; OECD (2009a), Economic Policy Reforms: Going for Growth.

Box I.3. **Green measures in investment stimulus packages**

Although most countries included green measures, the share of "green" elements in the stimulus packages varies significantly. Public investment in Korea was driven in part by the "Green New Deal Policy" announced in January 2009, which included major infrastructure projects such as the Four Major Rivers Restoration Project and railroad construction that boosted short-term public employment. With the new programme, the government hopes to create nearly 1 million jobs over the next four years, mainly in environmentally focused construction projects and other "green" programmes. In Australia, AUD 3 239 million were announced for energy-efficiency measures for homes. The package included assistance for the installation of insulation in homes and a solar hot water rebate programme. In the United States, the American Recovery and Reinvestment Act (ARRA) contains a focus on the renewable energy sector through wind and solar energy. ARRA requires states to direct part of their stimulus funding to green investment, such as water and domestic renewable energy industry, R&D, water quality improvement projects, storm water infrastructure and other innovative treatment technologies (Hanak, 2009). In Canada, green measures account for approximately 8% of the stimulus plan, with a particular focus on sustainable energy.

Source: Country cases, see Part II.

The crucial role of sub-national governments in the recovery

Although investment strategies were mostly designed at the national level, sub-national governments have played a key role in implementing investment measures. Some OECD countries have also specifically targeted fiscal recovery packages towards sustaining public investment at the sub-national level, to prevent pro-cyclical measures and to ensure coherence in the overall government response to the crisis (Bloechliger *et al.*, 2010).

Support from national governments to sub-national governments was particularly needed as SNGs were severely hit by the crisis. While the impact of the crisis on sub-national finances varied across countries, most SNGs struggled with a "scissors effect" of decreasing tax revenues and rising expenditure (Bloechliger *et al.*, 2010). Tax revenues fell sharply as a consequence of declining economic activity. In some cases, this was compounded by additional tax cuts foreseen in national recovery packages. In countries in which sub-national governments primarily rely on a pro-cyclical tax base, such as corporate or personal income taxes, the decline in revenues was particularly drastic. At the same time, the crisis led to higher spending on unemployment, social protection and social welfare more generally. In many OECD member countries, sub-national governments are responsible for welfare services and social transfers.

The situation of sub-national governments is important because they may take measures to balance their budgets that work against national counter-cyclical efforts, and their financial difficulties may affect public service delivery and lead to a decrease in public investment. In order to counteract these effects and support sub-national public investment, central governments adopted two types of measures:

- Many stimulus plans contain large grants/contributions for sub-national governments, mainly for financing capital expenditure, although there has also been some support for current expenditure. Grants earmarked for capital investment represent 56% of national stimulus spending in Australia, 27% in France, 26% in Germany, and more than 70% in Spain and Korea (Table I.1).
- National governments have also sought to encourage sub-national investments and accelerate anticipated infrastructure spending. In 2009, the French central government advanced the reimbursement of VAT to SNGs that committed to maintain their capital expenditure above the 2004-07 average. In Canada, the federal government streamlined and accelerated approvals under the Building Canada Fund as well as the Provincial/Territorial Base Fund, both of which are components of the Building Canada Plan that was launched in 2007.

Table I.1. Measures adopted by central governments to support sub-national public investment

	Share of investment spending that transits through SNGs as a % of total national investment stimulus	Grants to SNGs	Other types of measures to support local investment
Australia	56%	Investment programmes funded by the Nation Building Plan were largely implemented by Australian states and territories through their agencies as well as through commercial contracts that they put in place.	
Canada	30%	Through the federal stimulus plan sub-national governments are expected to contribute at least CAD 14.0 billion in stimulus in addition to the federal contributions of CAD 48.1 billion. They are to contribute, at a minimum, an additional CAD 7.3 billion to support infrastructure investments (federal funds are only supposed to cover part of the cost of infrastructure projects). Sub-national governments will also provide CAD 2.2 billion to the federal investments in educational and knowledge infrastructure.	Acceleration of investment funds for local governments
France	27%		In addition to additional national investment funding, local governments have been able to accelerate planned investment through a one-year advance of VAT reimbursements for an expected total of EUR 3.6 billion in VAT refund payments.
Germany	26%	The sub national investment scheme accounts for around 26% of the funds provided by the stimulus package II.	
Korea	75.2%	Around 75.2% of the investment package is targeted at sub-national governments (KRW 7.6 trillion out of KRW 10.1 trillion).	
Spain	73%	The EUR 8 billion state fund for local investments accounts for the lion's share of the Spanish stimulus measures and focuses on infrastructure investments.	
United States	One-third of total ARRA funding administered by states	Of the USD 787 billion recovery package, USD 275 billion was allocated for contracts, grants and loans aimed at supporting public investment measures, which amount to 35% of the recovery package. Out of the USD 787 billion of the stimulus plan, USD 286 billion is administered by states and municipalities.	Non-replacement rule for infrastructure investment

Source: Results of the 2010 OECD questionnaire and updated from OECD (2010b).

A global crisis, but regional management of its impacts

The crisis has helped to make more obvious the need for a regional approach to recovery and reinvestment strategies, as the impact of the crisis has not been uniform across regions. The severe contraction experienced in the OECD area during 2008-09 has

had substantial, lasting but highly variable effects on labour-market outcomes (OECD, 2010i). The variation in unemployment rates across regions in the OECD in 2009 exceeded the variation across countries and the variation in the *rise* in unemployment rates during 2008-09 was likewise greater across regions than countries (2011b).

The rise in unemployment has been larger in more vulnerable regions and/or those specialised in vulnerable sectors, in particular in manufacturing regions (*e.g.* the automotive sector). A 2010 survey in France revealed that 63% of employment losses during the crisis were located in the industrial sector, largely concentrated in Franche-Comté, Champagne-Ardenne, Picardie and Auvergne (INSEE, May 2010). In the United States, job losses have been most severe in areas that had experienced a big boom in housing, those that largely depend on manufacturing and those that already had the highest unemployment rates before the crisis.[10]

Although all types of regions – rural, intermediate and urban – have been affected in different manners depending on their industry mix, the shock in most countries seems to have been concentrated in and around urban areas (OECD, 2011b). For example, the impact was larger in urban regions in Canada and the United States. However, in Sweden and Spain, while urban regions suffered the largest absolute impact in terms of job losses, the relative impact appears much larger in intermediate and rural regions close to cities (Sweden) and in intermediate remote regions (Spain). In the United States and Spain, the more vulnerable regions (those with the highest initial unemployment rates) saw unemployment rise the most during the crisis; this was less the case in Canada and Sweden (OECD, 2010h).

I.2 Managing investment across levels of government: key challenges

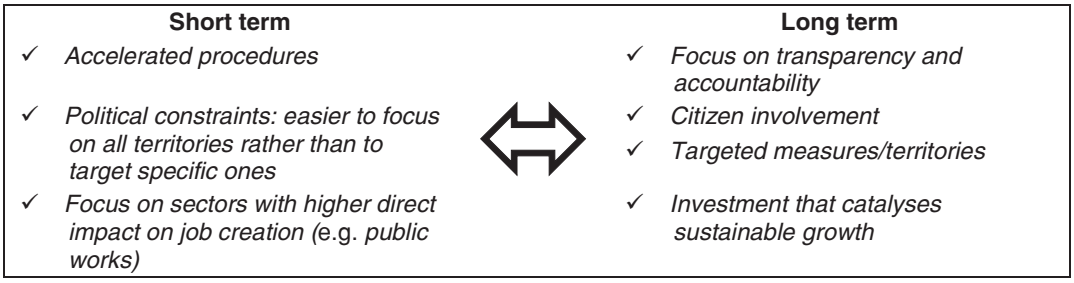
This section explores the extent to which national investment strategies launched during the crisis were carried out and the difficulty of combining timely and well-targeted investment. It highlights the challenges encountered during implementation and the obstacles that may limit the impact of that investment on long-term growth.

The difficulty of implementing both timely and well-targeted investments

Urgency as the leading criterion in the selection of projects

Investment recovery strategies launched during the crisis have had to take a difficult path: they have to be, like other stimulus measures, timely, temporary and targeted. They have 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 launched during the crisis suffered 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 for the long term.

Figure I.5. Trade-off between short- and long-term objectives



Most investment strategies sought to accelerate "shovel-ready" infrastructure projects, i.e. projects whose planning was well advanced and ready to be launched. A crisis does not lend itself to designing complex investment projects which typically require careful and lengthy strategic planning, cost-benefit analysis and environmental reviews. Countries and sub-national governments had to rely on already defined strategies and on projects already in the pipeline. The tension between short-term and long-term impact was largely arbitrated in favour of measures with the highest impact on jobs in the short term. This had an effect on the type of projects selected.

There is no optimal solution. For example, to create jobs, it might be more effective to focus on maintenance work, which is labour-intensive, rather than to build new facilities or public transport, which are relatively less labour-intensive in the first stages, as they involve higher non-labour costs for materials and land acquisition. However, new facilities may have a higher impact on long-term growth. What is crucial is to set objectives clearly from the beginning and to try to distinguish between investment measures that support job creation in the short term and those with a longer term impact.

Sectoral rather than place-based approaches to investment

Given the macroeconomic nature of investment packages, governments have focused on sectoral priorities, rather than place-based ones (Table I.2). To facilitate the quick adoption of recovery plans and limit political resistance, there has been little differentiation among territories in terms of allocation of funds. Overall, the focus was on spreading resources across the entire territory rather than targeting for territorial impact. In many cases, grants were allocated on a basis of GDP per capita and population, sometimes completed by other criteria such as the unemployment rate. The focus has tended to be more on equity than on maximising growth. For example, metropolitan areas or clusters were not specifically targeted in national priorities in the countries covered by the study (except in Korea and Sweden). In the United States, the allocation of funding across states was balanced so that different interests and types of states (metropolitan areas, rural states) received significant funding.

The role of local governments has been to make the most of the investment funding and, when possible, to exploit complementarities across the different vertically designed and segmented programmes. Although explicit targeting to specific places has remained limited, *implicit targeting* – linked to local capacities to design and implement investment programmes – has played a role, as will be explained below.

Table I.2. Targeted policy areas/territories for investment funding during the crisis

	Targeted sectors/policy areas	Targeted territories
Australia	Spending on both "shovel ready" projects and longer term nation-building projects in key priority areas of education, social housing, hospitals and health, and transport, including: – School infrastructure: AUD 16.2 billion – Social housing: AUD 5.6 billion – Metro rail: AUD 4.6 billion – Higher education and research infrastructure: AUD 3.7 billion – Clean energy: AUD 4.5 billion – Hospitals and health infrastructure: AUD 3.2 billion	All territories targeted. Allocation based effectively on population per state. No matching requirement from states, but requirements to maintain levels of investment.
Canada	– Total investment: CAD 18.257 billion – Core infrastructure spending (CAD 15.7 billion federally) – includes support for home ownership and the housing sector of about CAD 3.76 billion as well as investments in social housing of CAD 4.07 billion. – Other priorities are investments in highways, road and bridge infrastructure, green infrastructure (water and wastewater infrastructure), public transit infrastructure and recreational infrastructure – Investments in educational and knowledge infrastructure (CAD 2 billion federally) investments in federal labs (CAD 0.2 billion federally)	All territories targeted, no specific focus. Matching requirement from provinces for most major infrastructure and social housing funds.
France	Infrastructure (roads, rail, bridges, ports, higher education, student housing, military equipments, patrimony Short-term focus of the Recovery Plan For the long-term: France launched a plan in 2010 to finance "Investments for the Future" amounting to EUR 35 billion to finance five strategic priorities: higher education, industry, SMEs, sustainable development, broadband networks	For the *plan de relance*, all territories are targeted with no distinction (except specific additional funds for *Outre mer*). Municipalities are the key recipients of investment funding. For the "Investments for the Future" plan, projects will be selected on a competitive basis.
Germany	The first stimulus package allocates EUR 2 billion for infrastructure investments The second stimulus package foresees a total of EUR 17.3 billion for investments in educational facilities, hospitals and infrastructure (particular focus on energy-efficient renovation, thereby contributing to long-term environmental sustainability)	All *Länder* are targeted by the sub-national investment scheme of EUR 10 billion (plus EUR 3.3 billion co-financing by *Länder*). The distribution formula is a combination of several factors, including the population of the *Länder*. The *Länder* governments are required to invest a minimum of 70% of these funds in the municipal infrastructure.
Korea	Reinforcement of existing investments (front loading of fast train construction, urban train construction) and shovel-ready investments (construction of roads, redevelopment of rivers) Transport networks Energy infrastructure Other projects in the areas of agriculture, education, public services, environment protection, housing, health and defence	Funding focused in priority on metropolitan regions and cross-border regions. Municipalities are key implementers.

Table I.2. Targeted policy areas/territories for investment funding during the crisis *(cont'd)*

	Targeted sectors/policy areas	Targeted territories
Spain	32%: investment in the renovation and improvement of public spaces 29%: investment in basic infrastructure 17%: cultural, educational and sporting facilities and buildings The remaining funding was used for social, healthcare and funeral facilities, the promotion of road safety, the conservation of historic heritage, etc. Investment in research and development amount to EUR 500 million	Municipalities the key target Fund allocation based on number of residents
Sweden	Investment accounts for around 5% of the stimulus measure and includes funding for R&D in the automobile sector (SEK 23 billion) and funding for infrastructure investments (roads and railway, SEK 1 billion) and vocational education	Specific clusters were targeted, especially the vehicle industry in Västra Götaland region and Blekinge County.
United States	Spending is in priority earmarked for traditional areas of federal capital investment such as transport (in particular construction and repair of roads and bridges) and water resources ARRA has also a new focus on green investment, in particular in the areas of renewable energy and energy efficiency	The allocation of funding across states has been balanced so that all types of states (both those with much of their population in metropolitan areas and those with large rural populations) receive significant funding, to balance the different interests. ARRA selected some programmes that favoured urban states such as Medicaid support and the public transit programme; some that favoured rural states such as highway aid; and others that favour high-poverty areas. ARRA aims to give priority to projects that are located in economically distressed areas, as defined by the Public Works and Economic Development Act of 1965.

Most funding had been allocated by fall 2010

Most investment strategies adopted a time frame for the use of funds, with a specific deadline for allocation. Except for Sweden (which had relatively little investment funding in its overall stimulus package), all other countries set specific deadlines for the use of funds. France, Korea and Spain had the tightest deadlines, as most funds had to be spent by the end of 2009. In Korea, funds that were not spent during 2009 were withdrawn at the end of the year. In Spain, projects needed to start between 11 January and 12 April 2009 and end within the first quarter of 2010. In Canada, most temporary stimulus measures were expected to end as planned by 31 March 2011. The government extended the deadline by one full construction season to 31 October 2011 for remaining projects under four of the main infrastructure programmes. The extension will be cost-neutral to the government. In Australia and the United States, the time frame varies according to projects, and runs beyond 2010 for some projects. In the United States, funds for infrastructure projects for states and municipalities had to be committed within one year (by 30 September 2010) and the legislation includes programme-specific use-it-or-lose-it clauses that require states to commit available funding within a specified time frame to prevent re-appropriation to other states.

Because of specific sunset clauses, investment funding has been implemented quickly in most OECD member countries (Table I.3). By the end of 2010, most countries had already **allocated** more than 90% of the funds, in part through local governments (Australia, Canada, France, Korea, Spain, United States). In Korea, local governments spent 5.8 percentage points more of their budget than the initial target (KRW 96.3 trillion *vs.* a target of KRW 91 trillion) in the first half of 2010.

Spending has been slower, and there are significant variations across policy areas. In the United States, 100% of the USD 275 billion in investment funding had been allocated by November 2010 of which 53% had been paid out. At the state level, the General Accountability Office reported in May 2010 that in 2009 the federal government had spent aid to states for education and health the fastest, while spending in other areas, such as infrastructure and research, was largely still to come. Expenditures for health and education represented 88% of total outlays to states and localities in 2009. Outlays for transport, income security, energy and the environment, and community development were all substantially less (GAO, 2010b). However, it is projected that investment spending, in particular for transport and environmental priorities, will represent two-thirds of state and local ARRA funding after 2011.

The impact on growth and employment has yet to be fully assessed

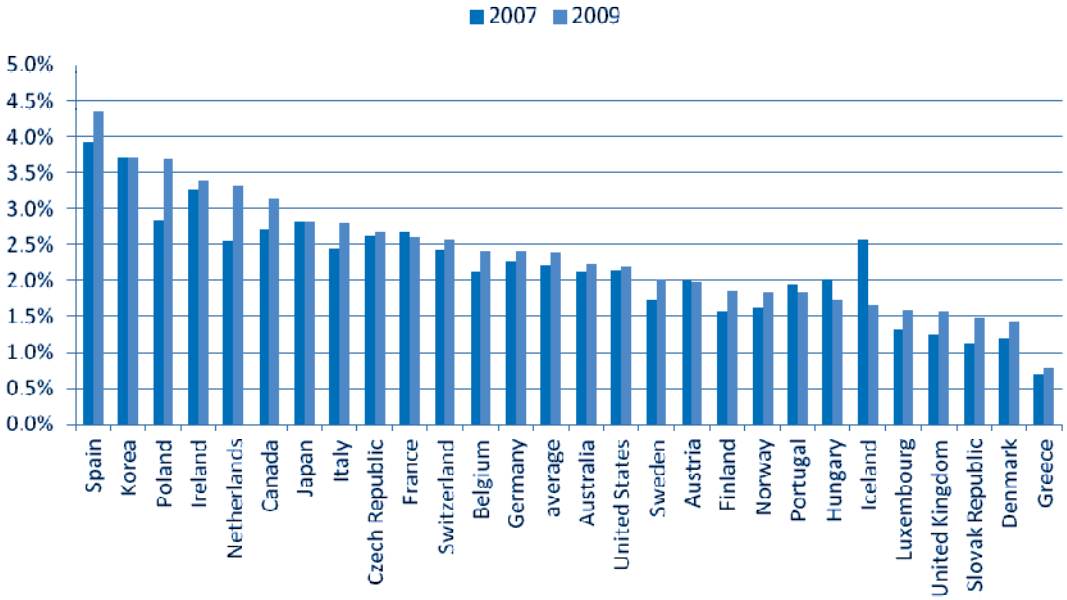
The economic impact of stimulus packages is extremely difficult to assess given the many factors involved. In particular, it is very difficult to fully disentangle the impact of investment measures from other recovery measures. Analysis conducted by the OECD in 2009 highlights that, other things being equal, spending multipliers are larger than tax multipliers, in both the short term and the long term, and multipliers are larger in the second year after the impact, for both tax relief measures and purchases of goods and services (OECD, 2009a; Padoan, 2009).

Table I.3. Total investment funding allocated across levels of government by September 2010

Country	Investment funding allocated by September 2010	Sunset clause
Australia	Over 99% of available stimulus funding tracked by the Office of Co-ordinator General had been allocated to approved projects by September 2010. The majority of investment funding is expected to be spent by 2011.	If sub-national governments are unable to spend the whole fiscal package allocated to them in the time frame required, the Australian Government can reallocate the funds. The time frame varies according to the type of project.
Canada	98% of 2010-11 funding committed	Most stimulus measures to end by March 2011. The government has extended the deadline to 31 October 2011 to allow completion of remaining projects under the main infrastructure programmes at no additional cost to the government.
France	93.7% of stimulus package either paid out or allocated. Two-thirds of public investment funding allocated in 2009	75% of funds had to be spent in 2009.
Germany	94.3% of the EUR 10 billion of federal investment grants had been allocated by mid-August 2010	Investment had to start by end of 2010, unused federal funds expire at the end of 2011.
Korea	100% Local governments spent 5.8 percentage points more of their budget than the initial target (KRW 96.3 trillion *vs.* target of KRW 91 trillion) in the first half of 2010	If funds were not spent during 2009, they were withdrawn by the end of the year.
Spain	Almost all of the funding, 99.9% or EUR 7.9 billion was spent within the anticipated period.	Projects needed to start between 11 January 2009 and 12 April 2009 and end within the first quarter of 2010.
Sweden	Between 25% and 50% of infrastructure investment spent, most funding expected after 2011 (no specific sunset clause in the use of funding).	There is no specific sunset clause in the use of additional national investment funding in Sweden. The investment measures were mainly small, largely maintenance measures. This meant that the measures chosen did not require lengthy preparation and could be implemented with short notice.
United States	In October 2010, 71% of the ARRA funding had been paid out according to the official government website. As of 22 October 2010: – 55% of the category "contracts, grants and loans" – which mostly finance public investment – had been paid out (USD 152.1 billion) and almost 80% had been allocated (USD 219 billion) – 84.5% of tax cuts (USD 243.4 billion) had been awarded – 73% of entitlements (USD 165.7 billion) had been paid out – Out of the USD 286 billion administered to states and localities, USD 114.8 billion, or 41% had been paid out by the federal government on 7 May 2010 (GAO)	For investment projects, most funds for states and municipalities had to be obligated within one year (by 30 September 2010). The Recovery Act gives priority to projects that can be completed in three years (beginning in FY 2009 and ending in FY 2011). The legislation includes programme-specific use-it-or-lose-it clauses that require states to obligate available funding within a specified time frame to prevent re-appropriation to other states.

Although it is too early to fully assess the impact of investment funding, there is evidence that the strong national support to public investment in 2009 helped to prevent a fall of investment, in particular at the sub-national level. In Canada, Italy, Norway, Poland and Spain, there was an increase in sub-national investment in 2009 (Figure I.6). In France, Germany and the United States, national support essentially prevented a decline in investment that might otherwise have been significant[11].

Figure I.6. **Sub-national government capital expenditures as percentage of GDP, 2009 compared to 2007**



Source: OECD National Accounts (2010).

Implementation challenges across levels of government

The crisis has made more obvious the multi-level governance (MLG) challenges that are inherent to decentralised political systems (see Table I.4 and box I.4). 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 policy challenge, and the difficulty of exploiting synergies across different sectors and policy fields; iii) the capacity challenge, linked to inadequate resources, staffing or processes for rapid, efficient and transparent implementation of investment funding; 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 more important 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 significant variations *within countries* on the degree of the different gaps. For example, metropolitan areas are likely to have fewer challenges in terms of local capacities than other areas.

Table I.4. Mutual dependence across levels of government: multi-level governance challenges/gaps in OECD member countries

Types of challenges/gaps	Co-ordination challenges/gaps
Funding	Unstable or insufficient revenues undermining effective implementation of responsibilities at sub-national level or for shared competencies **=> Need for shared financing mechanisms**.
Administrative	Occurs when the administrative scale for investment is not in line with functional relevance as in the case of municipal fragmentation **=> Need for instruments for reaching "effective size" (co-ordination tools among sub-national units; mergers).**
Policy	Results when line ministries take purely vertical approaches to cross-sectoral policies, to be territorially implemented **=> Need for mechanisms to create multi-dimensional/systemic approaches and to exercise political leadership and commitment.**
Information	Asymmetries of information (quantity, quality, type) between different stakeholders, either voluntary or not **=> Need for instruments for revealing and sharing information.**
Capacity	Arises when there is a lack of human, knowledge or infrastructural resources available to carry out tasks **=> Need for instruments to build local capacity**.
Objective	Exists when different rationales among national and sub-national policy makers create obstacles for adopting convergent targets. Can lead to policy coherence problems and contradictory objectives across investment strategies **=> Need for instruments to align objectives**.
Accountability	Reflects difficulties in ensuring the transparency of practices across different constituencies and levels of government. Also concerns possible integrity challenges for policy makers involved in the management of investment **=> Need for institutional quality instruments => Need for instruments to strengthen the integrity framework at the local level (focus on public procurement) => Need for instruments to enhance citizen's involvement.**

Source: Charbit and Michalun (2009) and Charbit, C. (2011).

Box I.4. OECD approach to multi-level governance challenges

The relationship among levels of government that result from decentralisation is characterised by mutual dependence, since it is impossible to have a complete separation of policy responsibilities and outcomes among levels of government. It is a complex relationship, simultaneously vertical, across different levels of government, horizontal, among the same level of government, and networked. Governments must first try to bridge a series of "gaps" between the vertical and the horizontal levels.

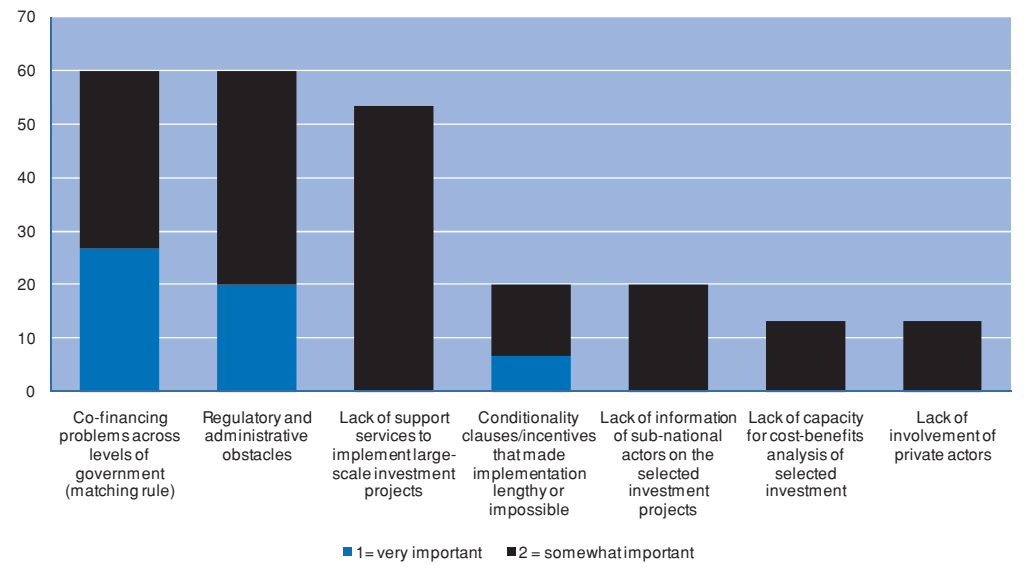
These gaps include notably the **fiscal capacity** of governments to meet obligations, **information asymmetries** between levels of government, gaps in **administrative accountability**, with administrative borders not corresponding to functional economic and social areas at the sub-national level, **gaps in policy design**, when line ministries take purely vertical approaches to cross-sectoral regulation that can require co-design or implementation at the local level and often a lack of **human, or infrastructure resources** to deliver services. Countries may experience these gaps to a greater or lesser degree, but given the mutual dependence that arises from decentralisation, and the network-like dynamics of multi-level governance, countries are likely to face them simultaneously.

Source: Charbit, C. and M. Michalun (2009).

Box I.5. **Main obstacles and co-ordination challenges or gaps in the implementation of investment strategies across levels of government (September 2010)**

Answers to a survey conducted by the OECD in September 2010 among European state territorial representatives* in the context of this project indicate that the most important challenges for the implementation of investment strategies have been: *i)* co-financing problems; *ii)* administrative and regulatory obstacles across levels of government; *iii)* lack of support services to implement large-scale investment projects (Figure I.7).

Main obstacles and co-ordination challenges or gaps in the implementation of investment strategies across levels of government (% of responses)



Source: OECD questionnaire, answers from State Territorial Representatives representing 15 European countries, September 2010.

* The collection of answers was possible thanks to the support of the *Association of European State Territorial Representatives* (EASTR) in September 2010.

Fiscal challenge: lack of coherence across levels of government

During the crisis, some national and SNGs have adopted conflicting policies. While national governments were focusing on stimulus spending, sub-national governments tried to reduce expenditures. This was particularly the case in countries where SNGs have to comply with balanced-budget requirements. In the United States, 49 out of 50 states have balanced budget rules enshrined in their constitutions so that any reduction in revenues must be compensated by an equivalent reduction in spending. SNGs were therefore forced to react pro-cyclically by cutting spending and raising taxes, although such policies could undermine the counter-cyclical fiscal policy of the national government (Bloechliger *et al.*, 2010).

National governments recognised this risk and responded with measures such as disbursing additional grants and lifting borrowing constraints. In the case of the United States, ARRA helped to offset some of the planned spending reductions and counter-productive tax increases at the state and local level. Funds disbursed through ARRA are estimated to have covered around 40% of the states' budget gaps (OECD, 2010b).

Another area in which national and SNG policies could conflict were earmarked grants provided by the central government to spur sub-national investment. The aim of these grants was to induce sub-national investment in soft and hard infrastructure that would otherwise not have been undertaken, so as to provide the needed boost to the economy. However, these measures provided incentives for sub-national governments to reduce their own investment spending in the expectation that the central government would step in. To ensure that central government funding would not crowd out sub-national investment funding, many recovery packages included complementary measures such as conditionality clauses and monitoring mechanisms. The Australian stimulus package, for example, included a mechanism for assessing whether Australian states and territories maintained pre-stimulus expenditure levels during the period of increased federal government expenditure. If a state's or territory's expenditure did not meet a pre-defined benchmark, the federal government reserved the right to require the state to return the shortfall in expenditure to the federal government.

Co-funding arrangements, also known as matching funding, are another a tool for ensuring that sub-national governments do not reduce their own investment spending in periods of high central government expenditure. In this case, sub-national governments must commit their own money in order to benefit from central government funding. Matching funding was an important element of investment strategies in Canada, Germany, Switzerland and the United States. In fact, Canada and Germany applied both conditionality clauses and co-funding arrangements. In the case of Canada for example, provinces and territories provided matching funding amounting to at least CAD 14.03 billion in addition to the federal stimulus plan of CAD 46.35 billion. Federal funding for infrastructure investments never exceeded 50% of project costs and most municipal projects were cost-shared at 33% of the total eligible cost. Provincial, territorial and municipal authorities needed to provide the remaining funding.

While matching funding is very useful as a means of mobilising additional funding, it presumes that sub-national governments have sufficient financial capacity. This is why matching funding is typically more common in countries in which sub-national governments have important autonomous revenue sources. However, during the economic and financial crisis, even sub-national governments in Germany found it difficult to provide matching funding. Governments of structurally weak regions especially struggled to gather sufficient funding. Under such circumstances, matching funding calls for complementary measures, so as not to disadvantage structurally weak regions and create territorial imbalances.

Policy challenge: the drawback of using urgency as a selection criterion

During the recession, micro-scale short-term infrastructure projects readily met the criteria for acceptance. The emphasis on speed in getting funds committed, although understandable, has probably overshadowed their economic impact. The sectoral investment plans represent a "missed opportunity" to integrate short-term recovery objectives within broader long-term cross-sectoral development strategies, taking into account specific territorial strengths and assets across countries.

In addition, not all countries and regions were able to mobilise "shovel-ready" projects corresponding to the level of stimulus spending available. This reveals a lack of strategic planning, probably connected to the decrease in infrastructure investment in many OECD member countries over the past decades. For example, Ken Henry, Secretary to the Treasury, Australia, mentioned in March 2010 that "attempts to bring infrastructure online as part of fiscal stimulus packages were hampered by difficulties in finding ready-to-deliver, nationally significant infrastructure investment proposals. As it happens, such projects were not simply lying on the shelf ready to be picked up and implemented by policy makers" (Henry, 2010). In the United States, because transport planners do not generally undertake detailed environmental reviews for infrastructure investment before funding is available, there were few unfunded shovel-ready projects.

Even when shovel-ready strategies were available, it was not always possible to mobilise them owing to the requirements for use of funding, notably the non-replacement rule in several countries. In the United States, for example, stimulus funds could not be used to replace funds already allocated to specific infrastructure projects. The combination of speed and the non-replacement requirement were particularly constraining in the transport sector. As a result, some 63% of highway funding (USD 16.2 billion) was spent on improving and widening pavement (GAO, 2010b).

Nationally launched strategies mainly took a vertical and segmented approach to investment. Priorities were therefore established in existing sectors and programmes. Although this provides some advantages for rapid implementation, it provides few incentives to enhance co-ordination. And while complementarities among investment priorities are usually better found at the regional/local level, regional actors had little time to try to identify possible complementarities and synergies, unless existing regional development strategies could be mobilised.

The crisis also revealed overly complex administrative rules and regulatory obstacles. For example, in some cases the lengthy procedures for public procurement sometimes did not fit the timeline for the use of investment funds. At the local level, procedures related to land-use planning and local permit and approval processes can significantly delay or even interrupt investment projects. Projects were often selected on the basis of their degree of complexity and readiness, and small-scale projects, easier to manage and implement, were generally favoured.

Administrative challenge: lack of appropriate scale for investment

Cross-jurisdictional co-operation is essential to target effectively the relevant scale for investment, to overcome administrative boundaries and to better correspond to the functional area. Mechanisms to increase municipal co-operation for public investment are increasingly being developed in order to better exploit of economies of scale and reduce jurisdictional overlaps in investment priorities for public goods with high externalities, such as public transport, water, environmental goods or higher education. [12] The problem of the scale of investment has been increasingly recognised in the past few years. In the water sector, for example, 45% of OECD member countries surveyed on water governance mentioned that the "lack of relevant scale for investment in the water sector" was a key issue (OECD, 2011c).

In unitary countries, municipalities, rather than higher tiers of government, have been the main implementers of investment stimulus funding. Yet, national governments (e.g. France, Korea, Spain or Sweden) rarely encouraged municipalities to co-operate on the implementation of investment measures. Moreover, municipalities had little time to

mobilise inter-municipal co-operation, as projects that involve different stakeholders are by nature longer to design and implement. The lack of co-operation on investment priorities at the local level is more problematic in countries with high levels of administrative fragmentation and affects the type of investments that are prioritised, which tend to be smaller-scale projects, with a lower return on investment.

- **France** for example, has 36 000 municipalities. Although instruments for co-operation among municipalities exist, they have not been greatly mobilised in the aftermath of the crisis. For example, very few *inter-communalités* subscribed to the national measure to support local investment through reimbursement of VAT one year in advance.[13] Most projects have been for renovating public works and carried out at the municipal scale.
- In **Spain**, although the State Fund for Local Investment allowed for joint applications, most municipalities did not avail themselves of this possibility. Only six out of 1 022 municipality associations applied for project funding, and the six projects proposed were negligible compared to the total of 30 699. Neither the regional nor the provincial level[14] was actively involved in the investment planning stage.

Capacity challenges exacerbated

In situations that call for urgent responses, the capacity gap (in competencies, know-how, organisational resources) is exacerbated at both the national government level (where insufficient local knowledge constrains its capacity to select relevant investment projects) and at the local level (where weaknesses in terms of strategy and implementation result in inadequate design, implementation and monitoring of projects). Given the stringent requirements for the use of funding and the rigorous reporting requirements, sub-national governments with efficient administrations which were able to take immediate action were likely to be the most successful in securing investment funding. Smaller municipalities and distressed areas therefore risked missing out on investment funding opportunities, unless they were clearly integrated into a regional strategy (as explained above). In the United States, for example, in a survey carried out in 2009 in Michigan[15] in more than 1 300 municipalities, 89% of small municipalities reported not having received funding, whereas two-thirds of large municipalities had received funding.

Capacity challenges were intensified by the pro-cyclical fiscal policies of some sub-national governments, which led to staff reductions.[16] Capacity gaps are often greater among secondary recipients in charge of implementation. In the United States, projects funded through "sub-allocated funds" (a compulsory requirement) could be awarded and administered through local transport agencies, which are often city or county agencies.[17] These agencies experienced difficulties in complying with the federal processes, requirements and time frame. According to Arizona Department of Transportation officials, some local agencies lacked the staff and experience to meet various federal requirements, such as obtaining right-of-way and environmental clearances.

Information challenge: top-down and bottom-up

Asymmetries of information have sometimes hindered the implementation of recovery strategies. In general, small municipalities tend to have more difficulty gaining access to information.[18] This also reflects municipalities' lack of an integrated strategy at the regional level. For example, the Michigan survey mentioned above indicates that

nearly half of Michigan officials reported feeling uninformed about opportunities available to their communities. Among officials who did not apply for stimulus package grants, many indicated lack of information as a primary reason (University of Michigan 2010).

The crisis has also helped to show that prioritisation of investment does not seem to rely on strong evidence, in terms of return on investment and cost-benefit analysis. There has been little evaluation of the long-term impact of investment plans. The US General Accountability Office and the French *Cour des Comptes* have warned in 2010 that more analysis was needed on whether the investments produce long-term benefits. In the United States, performance monitoring of projects financed by the Department of Transportation is based on inputs (such as number of kilometres of roads or level of expenditures) and does not cover outcomes or long-term objectives (Box I.6). In Korea, the *ex ante* evaluation of the investment project was relaxed; this compromised the opportunity to target projects with the highest long-term impact.

The information gap is not only bottom-up but also top-down, because of a lack of information and data on local needs. For example, economically distressed areas targeted by ARRA were defined by the Public Works and Economic Development Act of 1965, and may not necessarily have identified the areas most affected by the 2008 crisis. The information challenge is not due only to the urgency of the crisis situation, since an attempt to collect public investment data at the regional level in the OECD in 2009 has found that few countries track these data and know precisely what is going on in each region (OECD, 2009b). Also, few countries are known to publish regional breakdowns of public expenditure data nationally, and in many cases this information is difficult to compare with National Accounts and across countries[19] (OECD, 2009b). Overall, the crisis has revealed a number of issues in terms of the capacity of the statistical system to monitor public investment, and more broadly to monitor economic conditions in a timely and accurate manner.

Box I.6. **Performance monitoring for investment projects financed by the Department of Transportation (DOT) in the United States under ARRA**

The DOT developed a series of performance plans, released in May 2009, to measure the impact of ARRA transport programmes; these plans generally did not contain an extensive discussion of the specific goals and measures for assessing project impact. While the plan for the highway programme contained a section on anticipated results, three of its five measures were the percentage of funds obligated and expended and the number of projects under construction. The fourth measure was the percentage of vehicle miles travelled on pavement on the National Highway System rated in good condition. The fifth goal was number of miles of roadway improved. Most surface transport programmes lack links to the performance of the transport system or of the grantees, and programmes in some areas do not use the best tools and approaches – such as rigorous economic analysis – to ensure effective investment decisions. In addition, the quality of data collection varies across states, and some states currently measure, collect and track extensive performance metrics, based on their individual priorities and definitions. According to DOT officials, the department lacks the authority to require states to provide information that is not provided for by law.

Source: General Accountability Office (2010b).

Accountability challenge

The management of the crisis has led to accountability challenges, since the shortened decision-making process and the huge amounts of public spending created risks for transparency and integrity. Risks of capture and corruption are particularly high in such contexts, for example in local governments with insufficient capacity to monitor investment. The allocation of investment funding gave rise to considerable lobbying, and, to minimise the risks of corruption, in a context of high demand for public action, governments set up new instruments to monitor the use of funding. In that sense, the crisis provided an opportunity to develop new governance approaches across levels of government. These are explored below.

I.3. Overcoming obstacles to implementation: the need for co-ordination

The crisis has shown the strong need for co-ordination across levels of government in order to implement recovery strategies and overcome obstacles. A more co-ordinated approach may also ensure a better compromise between the desired short-term impacts on growth and employment, with long-term development objectives. There is no single toolkit of instruments to address each multi-level governance challenge, as the challenges are interdependent. Rather, governance instruments such as inter-governmental committees, contracts or financial mechanisms can address several challenges at once. This section examines whether the crisis has revealed the legitimacy of some governance arrangements and the need to create new ones to: *i)* bridge the policy and administrative gaps; *ii)* manage the fiscal challenge and enhance public-private co-operation; and *iii)* ensure accountability and transparency in the monitoring of large investment flows.

Strong need for co-ordination

Since the relationship among levels of government is characterised by mutual dependence, countries need to develop co-ordination arrangements to reduce a series of potential gaps or contradictions between policy objectives, fiscal arrangements and regulations across levels of government, which can undermine national strategies for growth. To the extent that policies of one jurisdiction have spillovers (i.e. negative or positive externalities) for other jurisdictions, co-ordination is necessary to avoid socially perverse outcomes (Hooghe and Marks, 2003). The previous section highlighted the possible costs that can arise from "non-co-ordination" across levels of government and actors. Rather than revealing that a unitary system would work better or worse than a federal system, the crisis has shown that co-ordination is critical to target investment strategies effectively. Either excessive centralisation or decentralisation in the design and implementation of investment strategies may lead to inappropriate results (Table I.5).

Table I.5. Challenges of excessive centralisation or decentralisation in implementing national investment strategies

Risks of excessive centralisation	Risks of excessive decentralisation
– Asymmetries of information	– Lack of coherence among national and sub-national strategies
– Investment not targeted to local needs	– Insufficient vertical co-ordination across levels of government
– Vertical approach to investment, insufficient complementarities across sectors	– Pro-cyclical policy at sub-national level in a crisis may hinder the national strategy
– Passive local governments, which do not complement national policies by their own efforts	– Lack of horizontal co-ordination across jurisdictions, risk of duplication in investment decision/waste

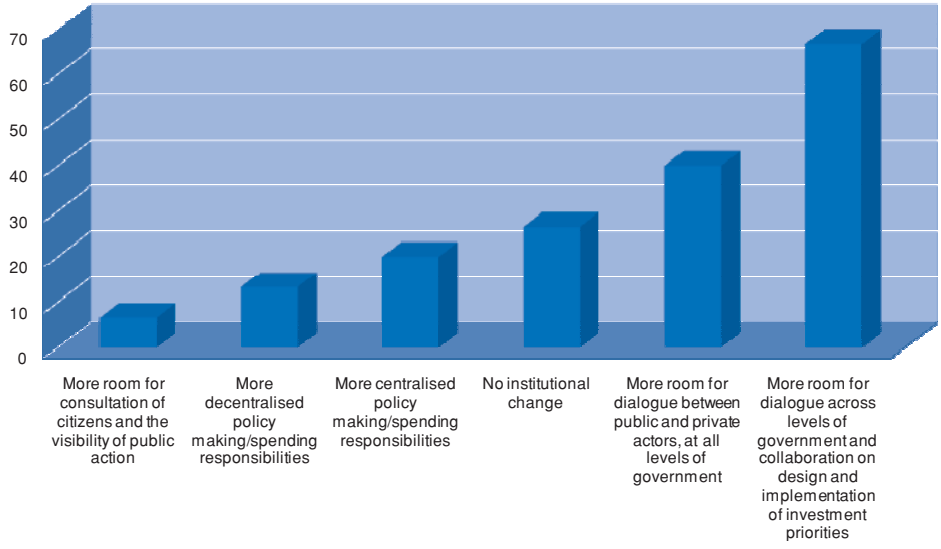
Answers from European state territorial representatives to an OECD questionnaire conducted in September 2010 highlight this "co-ordination imperative" (Box I.7). More than 60% of respondents reported that the level of co-ordination across levels of government for the implementation of public investment strategies has increased, compared to "normal" times. Most respondents also found that the crisis had made more room for dialogue across levels of government as regards the design and implementation of investment strategies (Figure I.8). Effective co-ordination in a crisis also requires proactive leaders who push boundaries and build relationships across organisations.

Box I.7. **Co-ordination across levels of government during the crisis: answers to the OECD questionnaire to European state territorial representatives**

During the recession, how would you assess the level of co-ordination across levels of government for the implementation of public investment strategies?

	Number of countries
High level of co-operation	8
Limited co-operation	4
Co-operation no different from "normal" times	3

To what extent have the crisis and its impact on multi-level governance arrangements led to institutional changes in your country? (% of responses, several responses possible)



Source: OECD questionnaire to state territorial representatives in 15 European countries, September 2010.

Box I.8. **Defining "co-ordination"**

Co-ordination is the act of making different interdependent people, agents and institutions work together in a consistent way for a common objective, goal or purpose. There is a continuum of modalities to co-ordinate activities of interdependent "agents", from "market mechanisms" based on competition, to integration into single authorities. In between, a great variety of types of co-operation exist, which engage partners in different ways, and may engender different types of transaction benefits and costs.

In multi-level governance, co-ordination mechanisms must be built to manage a co-operation that is unavoidable. In institutional economies, transactional contracting corresponds to a situation in which all co-ordination problems can be solved *ex ante* (at the time the contract is signed). It corresponds to a contract precisely stating the various tasks to be operated by the parties and the rewards they will get in return. In contrast, relational contracting corresponds to a situation in which co-ordination problems are predominantly solved *ex post* (during the performance of the agreement) because the parties decide how they should behave when they observe the situation they actually face.

Source: OECD (2007a).

How to limit the costs of co-ordination?

A key question is how to make the most of multiple actors and levels of government in policy making related to public investment, without creating too complex or costly procedures? Indeed, co-ordination itself has costs, which tend to rise exponentially as the number of jurisdictions rises (Scharpf, 1997). The costs of co-ordination include both direct and indirect costs, financial and nonfinancial costs (OECD, 2009r). Direct financial costs are attributable for example to transaction costs, staffing costs, monitoring costs and monetary incentives where they exist. Indirect costs include opportunity costs, administrative burden and unintended negative consequences. The opportunity cost of co-ordination is the foregone benefit associated with an alternative use of the resources it consumes. These costs are less quantifiable and more difficult to identify than direct financial costs. Different mechanisms and background conditions can help limit costs and maximise benefits of co-ordination (Box I.9).

The development of credible co-ordination mechanisms across levels of governments and SNGs takes time, is a learning process and may appear in a first stage inefficient. However, when properly designed in a clear accountability framework, long term benefits of co-ordination should largely outweigh its costs. OECD member and non-member countries are increasingly developing and using a wide variety of mechanisms to help bridge these gaps and improve the coherence of multi-level policy making. As will be explained below, the crisis has shown that these mechanisms have been particularly helpful for designing well-informed investment strategies, better targeting them and ensuring policy and fiscal coherence across levels of government. Since it is difficult to build them from scratch during a crisis, countries with well-developed co-ordination mechanisms have had an advantage in the management of the recovery.

Box I.9. How to limit costs and maximise benefits of co-ordination?

These framework conditions do not define an **optimal** level of co-ordination, but an "**enabling**" framework:

- **The objectives and targets of co-ordination need to be clarified and defined *ex ante* for the different parties**. The design of efficient co-ordination among levels of government should therefore be based on an in-depth understanding of the situation and of the goals of the co-ordination.
- **Co-ordination mechanisms need to be accompanied by incentives, to facilitate their acceptation and implementation** (such as co-funding mechanisms, performance indicators, capacity building, contracts, etc.).
- **Clear leadership at different levels of government and high-level political engagement in co-ordination procedures are essential to enhance credibility and enforcement of co-ordination mechanisms.**
- **Co-ordination mechanisms should be designed in a way** that allows flexibility and adaptation to context evolution, while preserving the sustainability of practices. In particular, they should go beyond electoral cycles to allow a long-term perspective.
- **The design of new co-ordination mechanisms should be carefully assessed through cost-benefit analysis**. Too many co-ordination instruments can be counter-productive. Experimentation and pilot initiatives may be useful to test new approaches.
- Finally, maybe the most important framework condition: **co-ordination across levels of government and SNGs clearly requires a high degree of transparency and trust across actors,** as well as well-developed information sharing mechanisms with citizens, private actors, NGOs, local actors, etc.

Source: Based on OECD (2007a); OECD (2009r) and own material.

Bridging the policy gap: mobilising existing instruments and developing new ones

Mobilising existing multi-level governance institutions

In most countries the national government made a strategic choice about policy design and then undertook an extensive effort to co-ordinate implementation across ministries and levels of government. Countries with well-developed co-ordination arrangements, such as inter-governmental committees or state territorial representatives, have had a comparative advantage in the management of the crisis, as it takes time to build co-operation arrangements and trust. 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 (Box I.10). Within the COAG framework, the Ministerial Council for Federal Financial Relations proved to be particularly useful. On top of existing structures, a newly created oversight group chaired by the co-ordinator-general as well as the network of national co-ordinators at the department level and co-ordinator-generals at the state and territory level provided a very timely and valuable governance framework for managing the implementation of stimulus measures.

Box I.10. **The role of the COAG in Australia in the governance of the crisis**

The Council of Australian Governments (COAG) is the main forum for the development and implementation of inter-jurisdictional policy. It is composed of the Australian Prime Minister as chair, state premiers, territory chief ministers and the president of the Australian Local Government Association.

The COAG was established in May 1992, but since 2007, the implementation of its reform agenda has been boosted by new Commonwealth leadership and new working arrangements, including the use of working groups of senior state officials chaired by a Commonwealth minister, to identify areas for reform and develop implementation plans.

During the crisis, the COAG created a number of new governance institutions to optimise the delivery of the stimulus package and ensure co-ordinated management. These new institutions included an oversight group within the Department of the Prime Minister and Cabinet. The oversight group, chaired by a co-ordinator-general, is responsible for developing project plans and monitoring mechanisms together with line agencies' state level authorities. Its tasks also include preparing reports on the progress of implementation for the COAG. The oversight group was complemented by the establishment of national co-ordinators nominated by relevant line agencies and by co-ordinator-generals nominated by each state and territory (Australian Commonwealth Co-ordinator-General, 2009: 12). Members of the oversight group, line agency co-ordinators and state and territory co-ordinators met every fortnight by teleconference to discuss the progress of the plan, share ideas and experiences, and identify and resolve critical issues. Co-ordinators at the line agency level meet every week.

Source: OECD (2010b), "Fiscal Policy Across Levels of Government in Times of Crisis", COM/CTPA/ECO/GOV/WP(2010)12, OECD, Paris.

State territorial representatives (i.e. representatives of the national government in territories), often saw their role increase during the crisis, including in the area of public investment. In France, regional and departmental prefects monitored response to the crisis in regions and reported to the central government on the sectors affected and the support measures needed. Monitoring efforts have been intensified in the ten regions the most affected by the crisis (Bretagne, Champagne Ardenne, Franche-Comté, Haute-Normandie, Lorraine, Midi-Pyrennées, Nord-Pas-de-Calais, Picardie, Poitou-Charente, Rhône-Alpes). In each of these regions a "reindustrialisation commissioner" has been appointed to work alongside the regional prefect in co-ordinating the various policy instruments available (EPRP, 2010). Prefects have also been involved in support to local authorities and supervision of investment measures, in particular the agreements for reimbursement of VAT (CFTVA). The inter-ministerial co-ordinating role of regional prefects has also increased. Prefects have also been directly involved in economic actions to support enterprises, in particular through banking mediation. In Switzerland, prefects have also played an important role for implementation, as have state and territory co-ordinators-general in Australia.

Creating new MLG institutions

The crisis also revealed the need for increased **horizontal** co-ordination at the central government level, as national investment priorities, such as "green growth" priorities, cross ministry lines. Countries such as France have set up new ministries in charge of the recovery strategy. Others, such as Sweden, have set up inter-ministerial committees in charge of monitoring the recovery plan, with an inter-ministerial group of state secretaries

to co-ordinate policy responses. In Slovenia, a co-ordination group of the Slovenian Government, led by the Minister of Development and European Affairs, was established to co-ordinate measures associated with the crisis.

To bridge the **vertical** co-ordination gap between levels of government that has appeared in a more obvious way during the crisis, several countries have created new institutions. The US Government has created new structures, such as the Office of Public Engagement and Intergovernmental Affairs,[20] an integral part of the executive branch, which aims to increase consultation and co-operation with state and local leaders. Sweden has set up regional co-ordinators to facilitate and strengthen the co-ordination of local, regional and national actors, policies and resources. The function of regional co-ordinators is carried out by the county governor and the political leader of the county council. Together they are in charge of reporting regularly to the government on economic developments in the county and identifying areas that require government support. While the functions of county governors and county council leaders were in place before, their collaboration on communicating investment needs to the central government is new.

Mobilising existing investment strategies

The tension between the short and long term in investment plans can be mitigated if they rely on pre-existing, well-defined strategies, which are flexible enough to be adjusted in response to a crisis. Priorities may have to be adjusted if a crisis reveals imbalances in certain sectors, but the ability to rely on an existing framework allows for a significant gain of time. The financial crisis highlighted the fact that, in many cases, countries and regions lacked appropriate strategies for prioritising investment, either because no strategies were in place or because many projects were ready to be launched, but there was no clear sense of their relative urgency. In such cases, regional policy and related governance instruments were valuable for prioritising investment.

Regional development strategies were mobilised during the crisis as a way to implement national packages. Reliance on these strategies provides the advantage of targeted priorities, in a balanced policy mix, generally identified with a large range of stakeholders in a cross-sectoral and multi-year perspective.

Regional development strategies have notably been mobilised in the European Union, as part of the EU Cohesion Policy.[21] Given that all EU countries are requested to have investment plans for 2007-13 for the use of EU cohesion funding, some European countries relied on existing regional development strategies to prioritise the public investment contained in the stimulus packages and to accelerate the use of EU funds.[22] The European Commission encouraged member countries to maintain high levels of public investment during the crisis and accelerated the disbursement of funds for already agreed projects, by advancing payments for the 2007-13 programmes. The Commission has focused its support on three priorities: more flexibility in the use of funding, giving regions a head start and focusing on smart investment (Box I.11). Many managing authorities have taken advantage of the opportunity to extend the closure date of the 2000-06 period and of the increased EU advance payment for the 2007-13 period.

Box I.11. Cohesion policy in the European Union Recovery Plan

In October 2008, the Commission proposed a series of measures to speed up the implementation of European Cohesion Policy programmes for 2007-13 to ensure that all Cohesion Policy resources are fully mobilised to support member countries and regional recovery efforts. These measures are based on recommendations to member countries and on specific legislative measures designed to accelerate investment and simplify the implementation of European Cohesion Policy programmes.

1) Flexibility

Modifying Cohesion Policy programmes: the existing Cohesion Policy programmes already have a strong strategic focus on jobs, business, infrastructure and energy, and research and innovation. These will continue to be priority areas of investment for Cohesion Policy programmes. Because of the ongoing economic crisis, the Commission is working with member countries to see if these programmes require any changes to meet the new challenges faced by Europe's regions and to simplify delivery of programmes and speed up their implementation.

Closing the 2000-06 programmes: the Commission has extended the final date of eligibility for the 2000-06 operational programmes to ensure maximum use of all Cohesion Policy resources for the period. Greater flexibility has also been introduced in the calculation of the final EU contribution. The Commission has also proposed several measures to simplify the financial management of the Cohesion Policy programmes in order to reduce the administrative burden. These measures include introducing lump sum or flat-rate payments for reimbursement and further facilitating contracting with the European Investment Bank (EIB) and the European Investment Fund (EIF) so that contracts can be awarded directly to the EIB or EIF.

Maintaining public investment: the Commission has encouraged member countries to maintain high levels of public investment to ensure that Cohesion Policy resources are fully mobilised to support recovery efforts. More flexibility has been introduced to encourage this type of investment, for example by allowing some measures to be financed at 100% through the EU funds in 2009.

2) Giving regions a head start

Increased cash flow: the Commission suggested increasing advance payments to the 2007-13 programmes. Additional advance payments released in April 2009 provided an immediate cash injection of EUR 4.5 billion for investment, within the financial envelope agreed for each member country for 2007-13. These funds have brought the total of advance payments to nearly EUR 23.3 billion since 2007.

Help with major projects: to help member countries advance the development of major projects, the Commission proposed to increase the resources available to JASPERS (Joint Assistance in Supporting Projects in European Regions) by 25% to help member countries prepare major projects from 2009 and to accelerate intermediate payments for major projects to help in the preparation phases.

3) Smart investment

The Commission has worked together with member countries to modify, if necessary, the existing Cohesion Policy programmes to put greater emphasis on smart investment, such as: investing in energy efficiency, clean technologies, environmental services, infrastructure and interconnections, broadband networks, forecasting and matching skills with future labour market needs or opening up new finance for research-intensive and innovative SMEs.

Box I.11. **Cohesion policy in the European Union Recovery Plan** *(cont'd)*

More energy-efficiency investments: the Commission has negotiated with member countries to include more energy-efficiency improvements and renewable energy schemes in housing in all member states.

Promote entrepreneurship and enhance co-operation with the European Investment Bank (EIB) and European Investment Funds (EIF)

Source: European Commission (n.d.), "Economic Crisis: The Response from European Cohesion Policy", European Commission, Brussels, *http://ec.europa.eu/regional_policy/funds/recovery*.

Established regional partnerships and long-term strategies were also crucial for speeding up decision making for the allocation of investment. In Sweden for instance, existing regional development programmes and regional growth programmes proved to be highly useful for prioritising investment. They can target priorities to reflect local needs and balance short-term and long-term concerns in a multi-sectoral perspective. Sweden, which was able to draw some lessons from the crisis of the 1990's, highlighted the need to maintain flexibility in order to adjust to new challenges arising from crisis.

Contractual tools involving different levels of government have also proven useful in channelling national stimulus funding. In Canada, the funding amounts under the Building Canada Fund – Major Infrastructure Component and the Communities Component are set out in the federal-provincial-territorial framework agreements. In France, existing state and regional investment plans for 2007-13 (CPER) were mobilised to accelerate certain projects, in particular for universities and high-speed rail. Although these investments did not necessarily start in early 2009, they constitute plans for firms and help to clarify medium-term prospects. The contractual approach provides several advantages, as the investment mix is designed through a cross-sectoral approach and the responsibilities of the national and the local governments are clearly defined.[23]

However, compared to the total investment funding available, regional policy tools have seldom been used during the recession. In unitary countries, the key actors at the local level have been municipalities rather than higher tiers of government. Even in Spain, the regional level was not involved in the management of the recovery. Political obstacles are part of the explanation, but the traditional reliance on sectoral approaches to investment policy, within macroeconomic national packages, have also prevailed during the crisis.

To a certain extent, countries such as Canada and Brazil, which had launched large-scale national investment strategies before the crisis, have had a comparative advantage, as they were able to accelerate investments already planned and to mobilise co-ordination instruments already in place across levels of government (Box I.12).

Box I.12. Anti-crisis tools: acceleration of national investment strategies in Canada and Brazil, with well-defined MLG arrangements

- **Canada had launched the Building Canada plan in 2007**, as the financial crisis had not yet manifested itself, for a seven-year period (2007-14). The plan consists of a federal investment of CAD 33 billion, and provided specific co-ordination tools with provinces and municipalities, in particular cost-sharing agreements. It focuses on key infrastructure priorities, such as water and wastewater, the national highway system, public transport and green energy. This plan, under which there is a toolbox of initiatives, was taking effect just at the moment it was most needed, when the United States entered recession in early 2008. As part of its stimulus efforts to fight the crisis, in addition to launching a new set of programmes, Canada also took steps to accelerate existing funding under the Building Canada plan, in order to further increase the amount of infrastructure investment during the 2009 and 2010 construction seasons. Having the strategic planning for investment in place under the Building Canada plan has facilitated the management of investment stimulus in an urgency context (*cf.* country note on Canada).
- **Brazil was in a similar** situation although it was less affected by the crisis than Canada and most OECD member countries. In 2007, Brazil launched an infrastructure development programme, the growth acceleration programme (PAC) to address bottlenecks and facilitate growth. It had BRL 638 billion (USD 349 billion) to be invested within three years in key infrastructure areas such as transport (road, trains, rivers), energy, ports and urban infrastructure (sanitation, housing). It required enhanced co-ordination across the federal government and states/municipalities. Although there were implementation challenges, with only 63% spent at the target completion date of March 2010, the overall impact has been viewed as positive and a countercyclical factor in cushioning Brazil's economy from the full effects of the world financial crisis. During the crisis, the government mobilised PAC to anticipate transfers to municipalities and provided special credit lines for long-term investment by states. The fact that procedures were already in place helped to act in the crisis situation, and PAC is considered to have served as a key anti-crisis tool.

Source: Country note on Canada (see part II) and *www.brazilglobalnet.gov.br*.

Some good practices for horizontal co-ordination across local governments

In a few cases, investment funding for the recovery has helped to foster co-ordination among municipalities. For example, in Alabama in the United States, elected officials from Birmingham, Bessemer, Hoover, Lipscomb, Graysville and Fultondale formed the Alabama Green Initiative (AGI) in an effort to obtain a portion of the grant money available for green development in the stimulus bill. In Massachusetts, a new framework for co-operation across municipalities was developed. In greater Washington, D.C., six municipalities elected to submit a joint application for ARRA funding to "pursue one multi-jurisdictional strategy for dealing with foreclosed and abandoned properties, including bulk acquisition, resale and rentals; financial assistance to homebuyers; and the transformation of some parcels to permanent supportive housing" (Muro *et al.*, 2009; Brookings Institution, 2009). In Germany, 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 Australia, the government encouraged

local governments to contribute funds or secure partnership funds for projects, in particular through the mobilisation of the Australian Government's Local Government Reform Fund.[24]

Using specific instruments for certain regions

The management of the crisis also highlighted the need to develop specific governance instruments for severely affected regions. For example, Slovenia adopted a law to support a north-east region, Pomurje, which was strongly affected by the crisis and the closure of a textile company. The act lays down additional development support measures for promoting the development of the Pomurje region during 2010-15 and the means of financing them. In Germany, the federal government earmarked loans to structurally weak local authorities in 2009-10. The need to bridge the fiscal gap has been one of the main challenges of the crisis, as explained in the following section.

Bridging the financial gap and facilitating public-private co-operation

In addition to discretionary grants, many OECD member countries streamlined and simplified procedures for approving and disbursing funds. This helped to speed up the trickle-down effect of grants by providing immediate liquidity to the private sector. Some central governments also facilitated sub-national borrowing by providing subsidised loans or explicit guarantees. Others eased sub-national budget constraints by waiving balanced budget rules. The Austrian Government, for instance, revised its Internal Stability Pact, allowing for higher sub-national deficits. Similarly, the Italian Government made temporary changes to its Internal Stability Pact to allow sub-national governments to increase their investment expenditure.[25]

Avoiding the crowding-out effect

As previously mentioned, earmarked grants for capital investment often give sub-national governments an incentive to reduce their own investment spending. Many recovery packages therefore included complementary measures, such as conditionality clauses and monitoring arrangements, to avoid the crowding out of sub-national funding of investment in a period of high central government spending.

Recovery packages in Australia, Canada, France, Germany, Spain and the United States included some sort of conditionality clause attached to earmarked grants. The exact specification of conditionality clauses varied but all ensured that central government funding was directed at sub-national investments that otherwise would not have been undertaken. In Germany and Spain, conditionality clauses exempted from financial support all sub-national investment projects for which funding had already been secured in the 2009 budget. In Australia and France, conditionality clauses required sub-national governments to maintain pre-stimulus investment spending levels. While conditionality clauses were meant to ensure that investments undertaken were truly additional to those already envisaged, they also needed to be flexible enough to allow sub-national governments to bring forward ready-to-deliver projects.

In addition, conditionality clauses require comprehensive monitoring arrangements. Sometimes the documentation required sub-national governments to prove the incremental nature of investments was so wide-ranging and laborious that it delayed the implementation of recovery strategies. Streamlined and transparent documentation and monitoring arrangements were crucial in avoiding unnecessary administrative burden.

Matching funding: helping financially weak regions

While co-funding arrangements proved to be very useful in mobilising additional investment, they also ran the risk of disadvantaging financially weak regions. This was especially the case when investment projects eligible for central government funding were selected according to the ability of sub-national governments to provide matching funding. To avoid a bias against financially weak sub-national governments, OECD member countries developed a number of compensating mechanisms.

In Canada for example, an existing Gas Tax Fund programme provides predictable and long-term funding of CAD 2 billion annually, for environmentally sustainable municipal infrastructure projects. Canadian municipalities can freely put this money towards construction, or pool, bank and borrow against this funding, providing significant additional financial flexibility. If they wish, municipalities can use their amounts under the Gas Tax Fund to finance part of their matching funding under certain stimulus programmes, as long as they respect the overall maximum (e.g. 50%) percentage of project funding that comes from federal sources. In Germany, some of the *Länder* disbursed parts of the funds for municipal infrastructure according to population and area size whereas other parts were distributed according to a special mechanism privileging financially weak municipalities. *Bundesländer* such as Nordrhein-Westfalen set up special funds to help municipalities finance their matching funding contribution.

Managing urgency: reducing administrative obstacles

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. Many OECD member countries accelerated their public procurement procedures. France eased rules for public procurement and urban land use which were considered too constraining in the context of recovery. In Korea, public procurement procedures were simplified and the procurement period was shortened from 79-90 days to 20-38 days. Evaluation of the traffic and environmental impact of projects was also sped up. The European Commission agreed on the use of accelerated procurement procedures for all major public projects throughout 2009 and 2010.

Some OECD member countries also mobilised e-government tools to increase co-ordination between levels of government. In Spain, for example, municipalities used an online procedure to apply for funding from the state fund for local investment. It seems to have been very successful in reducing bureaucratic burden and facilitating rapid absorption of funding.

Countries also introduced some flexibility in the multi-level regulatory framework, in particular for housing construction and spatial planning. For example, in the Netherlands, the Crisis and Recovery Act, the stimulus package accepted by Parliament in 2010 to tackle the economic crisis, simplifies laws and regulations that currently impede the progress of certain projects for housing construction, industrial estates and infrastructure. Some of these simplification measures concern specific projects that form part of the stimulus package in the Crisis and Recovery Act; they will expire in 2014. Other simplification measures (e.g. with respect to Natura 2000 areas) will continue beyond 2014.[26]

Facilitating public private co-operation

In a number of countries, anti-crisis measures included facilitating public-private partnerships[27] (PPPs) as a way to finance public investment projects. These measures are particularly important for sub-national governments (notably municipalities), which are responsible for the provision of infrastructure, the type of projects for which PPPs are mostly used.[28] The crisis had an immediate negative impact on the volume of PPP projects (OECD, 2010). As credit markets dried up, it was next to impossible to finance debt capital, and projects that had not already been finalised largely came to a standstill. In response, a number of countries attempted to unclog the PPP pipeline by making financing available in various forms. In particular, the United Kingdom, France, Korea and Portugal considered the PPP market as important for stimulating the economy in response to the crisis (Box I.13) and they made PPPs more appealing to the private sector by guaranteeing debt and/or supplying capital. PPPs are complex instruments which require a number of capacities to be present in government, and should be used with caution (Box I.14).

Box I.13. **The increased use of PPPs during the crisis**

The **Australian Government** is working to create a "seamless national economy" by promoting national markets and harmonising regulation. Through COAG, it has produced national guidelines on public-private partnerships.

Since public-private partnerships (PPPs) were first introduced in **Korea** by the Promotion of Private Capital into Social Overhead Capital Investment Act in 1994 and the Act on Private Participation in Infrastructure (PPI Act) in 1998 after the 1997 financial crisis, they have been used in projects managed both by the central and local governments. Major projects conducted through a PPP include the Seoul Beltway Northern Section, the Incheon International Express Highway, and the Busan New Port Phase 1. With the recent decrease in private demand and the sharp increase in the public sector, a first round of measures to revitalise PPPs was taken in February 2009 to ease the credit crunch (the introduction of the Korean Development Bank's Special Loan Programme and the Infrastructure Credit Guarantee Fund), followed by a second round in August 2009 (strengthened tax incentives and the development of a new risk-sharing scheme in October).

The **Canadian Government** has encouraged public-private co-operation in implementing infrastructure investments. The benefits of partnering with private or non-profit actors include increased access to capital and expertise and the distribution of investment risk among several partners. Typically, federal funds only cover 25% of the cost of projects undertaken by the private sector and 33% of the cost of those undertaken by non-profit partners. The Canadian Government had already started to set a track record of good public-private co-operation in the context of the "Building Canada" plan. In particular, it set up a CAD 1.25 billion Public-Private Partnerships Fund and a federal office (a Crown corporation called PPP Canada) aimed at facilitating co-operation.

The crisis led to new financial mechanisms in **France**, in particular public-private partnerships. France chose to set up a guarantee scheme to facilitate the use of PPPs, notably for local governments.

Source: OECD country notes 2010 (see part II).

Box I.14. The use of Public Private Partnerships (PPPs) at sub-national government level: the need for prudence

When engaging into PPPs, public actors need to carefully assess their advantages compared to traditional procurement. The underlying rationale for choosing PPPs over traditional procurement or private-sector provision is improved value for money. In addition, PPPs are long-term commitments that encourage a longer term view on capital spending, may support private sector recovery and build local capacities. However, the growing number of PPPs in recent years and their contractual structures may entail fiscal risks for governments that can be exacerbated in a crisis context. The challenges of using PPPs may be higher at sub-national government levels, given the potential lack of skills in the public sector to set up and manage PPPs. To limit government's exposure to risk, while preserving the private partner's efficiency incentives, intervention measures should be consistent with the wider fiscal policy stance, be contingent on specific circumstances, and be adequately costed and budgeted (Burger *et al.*, 2009). The introduction of PPPs for sub-national governments should be prudent, and PPP activity should be controlled through rules on PPP stocks and flows. Overall, PPPs have to be treated with caution, as they entail more risks for government than traditional projects.

Source: OECD (2008), *Public-Private Partnerships: In Pursuit of Risk Sharing and Value for Money*, OECD Publishing, Paris, doi: 10.1787/9789264046733-en and OECD (2011d).

Mobilising new financial instruments

Governments created a number of new financial instruments during the recession to stimulate investment, leverage private investment and diversify sources of funding for local governments.

- **Specific investment funds.** Some countries created state-owned investment funds. For example, France created a "*fonds stratégique d'investissement*" (FSI) in November 2008 to support enterprises looking for capital funding. By the end of 2009, the fund had been allocated EUR 20 billion by the state and the *Caisse des Dépôts et Consignations*, in part through their participation in strategic companies. The purpose of the fund is to support SMEs that have difficulty obtaining financing and to securitise the capital investment of strategic companies. The fund acts in conjunction with private partners to support long-term investment projects and companies that generate revenue.
- **New European Union investments funds.** For example, the European Investment Bank (EIB) launched Marguerite 2020 to finance investments in new greenfield infrastructure projects in the areas of transport (Ten-T), energy (TEN-E) and renewables. The fund is financed by the EIB and various national banks.
- **Investment funds set up by regions.** In France, the Pays de la Loire region adopted a EUR 629 million investment plan at the end of 2009 and raised a loan of EUR 80 million. The funds mobilised increased the pace of regional investment and allowed the establishment of a regional loan for industrial redeployment to provide backing for the most competitive firms.
- **Loans for sub-national governments.** Loans have been increasingly used to finance investment (Council of Europe, 2010). As the crisis originated in the

financial sector, loans are not readily available on the market. Regional banks such as Kommunalkredit (Austria), Kommunalkreditt (Norway), or Dexia (France-Belgium) were also hit hard by the crisis. Nonetheless, local government borrowing has increased in many countries. In particular, the new EU member countries actively used this method of financing, partly to raise funds for co-financing and pre-financing projects funded by the EU. These countries already had proper regulations on municipal borrowing (Council of Europe, 2010).

- **Reliance on bonds.** The forms of local government borrowing have been transformed as well.[29]Former bank loans have been gradually supplemented by a new wave of bond issues. Large cities in the Czech Republic, Hungary and Poland issue bonds more actively (Council of Europe, 2010). In the United States, Build America Bonds are a taxable municipal bond created under the American Recovery and Reinvestment Act of 2009 and carry special tax credits and federal subsidies for either the bond holder or the bond issuer. Many issuers have taken advantage of the Build America Bond provision to secure financing at lower cost than the issuance of traditional tax-exempt bonds. The Build America Bond provision was open to governmental agencies issuing capital expenditure bonds before 1 January 2011. The increased reliance on bonds at the municipal and state level is not without risks, in a context of high volatility of financial markets (see Section I.4).

Bridging information gaps and enhancing accountability

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 exceptional funding. E-government tools have been used in an unprecedented manner and have played a major role in ensuring the transparency of crisis-response measures, conveying relevant information and support to citizens and businesses, and encouraging feedback from citizens on alternatives for addressing the effects of the economic downturn (UNPAN, 2010[30]). Given the traditional difficulty of tracking investment funding at the local level, this constitutes a significant shift towards better practices. To what extent these efforts will be sustained after the crisis remains an issue.

Bridging information gaps

Most countries have set up strict monitoring frameworks across levels of government. Performance measures and indicators go well beyond the need to monitor the use of funds, as they help to bridge the information, capacity and objective gaps. They are in themselves tools for capacity building (OECD, 2008). To develop effective monitoring arrangements that would also take into account the concerns and dispositions of sub-national governments, some OECD member countries resorted to existing multi-level governance institutions. In Australia the Council of Australian Governments (COAG) provided the framework for streamlined and simplified monitoring arrangements. Its Ministerial Council for Federal Financial Relations agreed on specific expenditure and output benchmarks for the Australian states. Every quarter, states needed to report to the Heads of Treasuries on the activity undertaken against these benchmarks. Heads of Treasuries then collated the information and provided it to the Ministerial Council for Federal Financial Relations, which made a final assessment (Box I.15). In the more general realm of overseeing the implementation of funds, Korea set up a special reward mechanism. The Korean Ministry of Public Administration and Security (MOPAS),

which carried out mid-term comparative evaluations of local fiscal performance between January and March 2010, rewarded the best-performing local government with a special shared tax of KRW 10 billion.

Box I.15. New budgeting practices for monitoring the use of funds under Australia's recovery plan

As part of the Australian National Partnership Agreement on the Nation Building and Jobs Plan, the Ministerial Council for Federal Financial Relations of the COAG established expenditure and output benchmarks for each of the sectors to receive additional Commonwealth funding. Benchmarks took into account previously budgeted state expenditure as well as additional Commonwealth expenditure. Every quarter, states needed to report to the Heads of Treasuries on the activity undertaken against these benchmarks. Heads of Treasuries then collated the information and provided it to the Ministerial Council for Federal Financial Relations, which made a final assessment. If a state's expenditure did not meet the benchmark, the Commonwealth reserved the right to make the assessment public and demand a return of resources to be reallocated to other states or used for Commonwealth purposes (OECD, 2010b).

The expenditure benchmarks allow assessment of whether the states have at least maintained their existing and planned level of expenditure during the period of increased Commonwealth expenditure.

Monitoring the use of funds has gone well beyond traditional governmental or parliamentary control, as a central objective in most countries was to provide citizens and private firms with as much transparency as possible. Governments in France, Spain and the United States organised weekly or monthly press conferences to present progress made in implementation. Some countries have issued regular reports on the implementation of their economic stimulus plan. Canada for example had, as of February 2011, issued seven reports to track progress in implementation and describe challenges met.[31] In Australia, the Council of Australian Governments established an oversight group chaired by a co-ordinator-general. Its responsibilities include reporting to the COAG on the progress of implementing the Nation Building and Jobs Plan.[32]

In addition, most countries and regions have created websites that enable citizens to track stimulus packages and other public funds committed to addressing the crisis (UNPAN, 2010). In 2010 the United Nations tracked information on stimulus packages and other public funds committed to addressing the financial and economic crisis on 115 government websites (UNPAN, 2010). It found that 83% of the crisis-response websites studied used ICT to increase transparency. In addition, 40% included territorial information on the use of funding. In Australia, Canada, France and the United States, detailed information on the territorial use of funds is available on government websites (Box I.16).

Box I.16. Government websites with detailed territorial information on the use of funds

Best practices include the US ARRA website, which allows tracking recovery funding per state and programme. The *www.data.gov* website created in 2009 by the US Government provides datasets generated by the government in an accessible, developer-friendly format. It is one of the most substantial steps taken so far to provide such a platform for third parties (UNPAN, 2010).

In Australia, the government released a web portal that provides key information on the economic stimulus package and showcases developments in the implementation process. An interactive mapping tool called My Community allows citizens to track approved projects across the country. It also enables interactivity as citizens can ask questions. It provides links to sub-national websites of similar scope. The United States Recovery Act and the Australian Economic Stimulus Plan websites allow users to track funds by entering their postal codes. On France's stimulus website users can click on a map and find information on the allocation of recovery funds in the area selected and the total costs of individual projects taking place in the region.

The use of e-government tools to monitor funding has also significantly increased at the sub-national level (UNPAN, 2010). For instance, in the United States, all states currently run stimulus websites, which provide detailed information on the allocation per county and municipality. Maryland's website is considered the best for monitoring stimulus funds (Mattera, McIlvaine, Laicy, Lee and Cafcas, 2009). German *Länder* have also developed websites to monitor the use of funding, as have Canadian provinces and Australian states, as well as many French regions.[33] Although the general purpose of these government websites is to enhance public scrutiny, some sub-national governments have also used them to foster participation on economic crisis issues. In the UNPAN survey, 27% explored the prospects of ICT for promoting some kind of citizen feedback or participation. For example, in the district of Heathcote in Australia, citizens were invited to give their views through the Internet on the allocation of stimulus funds.

Bridging the capacity gap

Some instruments created in the wake of the crisis have helped to build local capacity for the longer term. In Greece, a special non-profit organisation was set up to assist small municipalities that lacked the necessary skills for preparing projects for EU structural funds (Council of Europe, 2010). The purpose was to help prepare four-year action plans for municipalities with a population of less than 10 000. E-government tools also have the potential to enhance capacity building in sub-national governments. A United States federal Government website helps recipients of recovery funds to meet quarterly reporting requirements by providing them with the means to submit project updates online.[34] The strong guidance put in place by the government has helped states and municipalities allocate funding within the set timeframe (GAO, 2010b).

Conclusion

The crisis has had enormous economic, financial and social repercussions throughout the OECD, but also deep implications for increasing the legitimacy of public governance. During the crisis, co-ordination across levels of government has proven critical for targeting investment priorities, ensuring coherence in fiscal policy and facilitating the

implementation of national strategies. Countries with well-developed co-ordination mechanisms across levels of government and policy areas were better able to manage stimulus packages and prioritise public investment to differentiated regional challenges, with a view to both short- and long-term recovery challenges. The crisis also provided an opportunity for public management reforms which can have lasting positive effects, such as better monitoring of investment performance, greater government responsiveness, and better co-ordination of agencies and levels of government. To what extent these efforts will be sustained and what MLG challenges will be raised in the current fiscal consolidation context, are addressed in the following section.

I.4. Making the most of public investment in times of austerity

In a short span of time (2008-11), most OECD member countries have rapidly switched from highly expansive fiscal policies to the tightest ones in decades. Just as co-ordination across levels of government was important to implement recovery measures, multi-level governance mechanisms are critical to managing consolidation. What is important in periods of expanding expenditure is even more relevant in times of budget cuts, which are more difficult to achieve because of resistance. A successful deficit reduction plan requires strong involvement of sub-national governments, to achieve both fiscal discipline at the local level, as well as the design of appropriate growth strategies across regions. This section explores the challenges that fiscal consolidation raises for multi-level governance of public investment and SNGs and identifies a series of guidelines for making the most of public investment across levels of government.

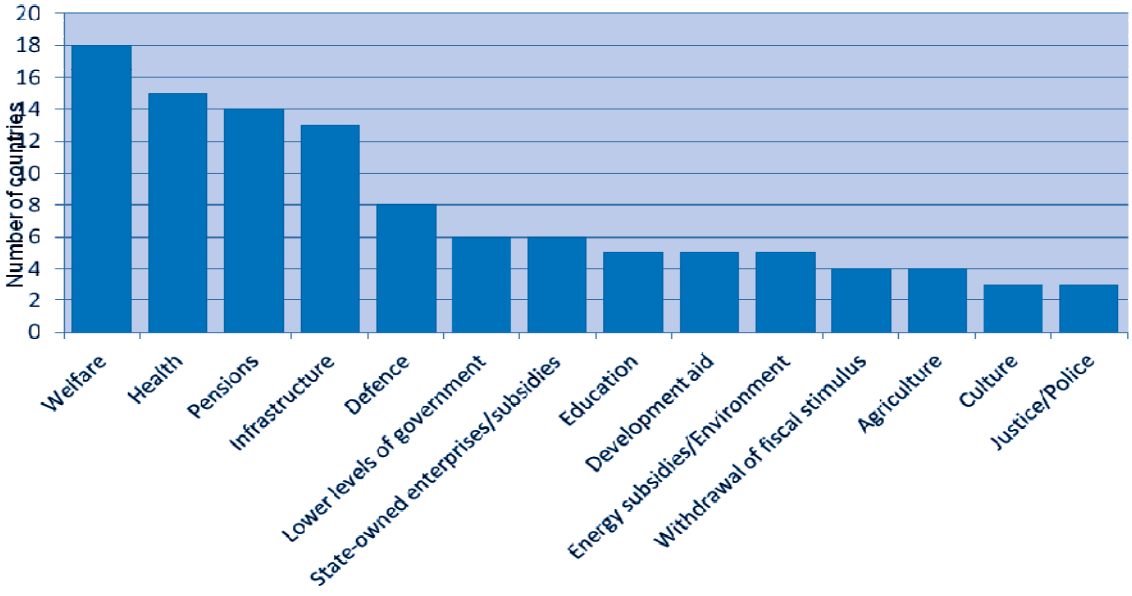
Multi-level governance challenges in fiscal austerity

From stimulus to consolidation: public investment, a priority in budget cuts

The crisis has left a strong and lasting imprint on OECD member countries' public finances. In 2011, gross government debt is expected to exceed 100% of GDP in the OECD area (OECD 2011a). As stimulus packages are phased out, many countries are planning some combination of spending cuts and tax increases in 2011 and beyond (Box I.17). The fiscal deficit in the OECD area was 7.9% of GDP in 2009 and was expected to improve only slightly in 2010 and somewhat more in 2011 (OECD, 2010f).

A recent OECD analysis of 29 member countries' consolidation plans (OECD 2011a) finds that in 2011-14, most governments will focus on expenditure cuts rather than revenue enhancement (Box I.17). The largest expenditure reductions come from reducing programme expenditures, in particular programmes on welfare, health, infrastructure and pensions (OECD, 2011a, see chart 1.8). Cutting public investment is a priority for budget cuts in many countries, with 13 of the 29 responding countries scaling back public investments in their consolidation plans (OECD, 2011a). In Portugal and Spain, stopping or postponing infrastructure projects by downscaling investment expenditures is one of the most important contributions on the expenditure side (OECD, ibid).

Figure I.7. **Fiscal consolidation strategies in OECD member countries: frequency of major programme measures**



Note: Out of a total of 29 countries.

Source: OECD (2010), "OECD Fiscal Consolidation Survey 2010", OECD, Paris.

Box I.17. **Fiscal consolidation strategies at the national government level in OECD member countries**

Many advanced economies are planning some combination of tax increases and spending cuts in 2011 and subsequent years as their stimulus packages expire and budget consolidation begins. Collectively, these may amount to a tightening of some 1.25% of GDP (IMF, 2010). This could be the biggest simultaneous fiscal squeeze since modern records began. Interestingly, this is roughly the percentage of global GDP that was injected into G20 economies as part of stimulus packages: 1.4% of the combined GDP of G20 countries and 1.1% of global GDP (Brookings Institution, 2009).

Fiscal challenges vary substantially across countries and regions; some face strong market pressures to reduce debt burdens while others have more room for manoeuvre. Countries in which financial markets have lost confidence have no choice and must undertake fiscal consolidation immediately.

While almost all OECD member countries have deficit targets over the medium term, about half have announced consolidation plans that include measures over the 2010-13 period. For countries with a consolidation plan, the size of the plan varies significantly depending on the country's fiscal position and the current status and time frame of the consolidation plan. Unsurprisingly, countries with the largest economic imbalances and the most rapid deterioration in public finances require larger fiscal consolidation. For example Greece and Ireland have introduced very large fiscal consolidation plans measured at around 22% and 17% of GDP, respectively. Portugal, Spain and the United Kingdom have also announced large fiscal consolidation programmes that equal 6-7% of GDP (OECD, 2011a).

Box I.17. **Fiscal consolidation strategies at the national government level in OECD member countries** *(cont'd)*

There is a significant variation in the composition of consolidation measures. A number of countries have based consolidation mostly on expenditure-based measures. Fiscal consolidation is weighted on average two-thirds towards spending cuts and one-third towards increasing revenues (OECD, 2011a).

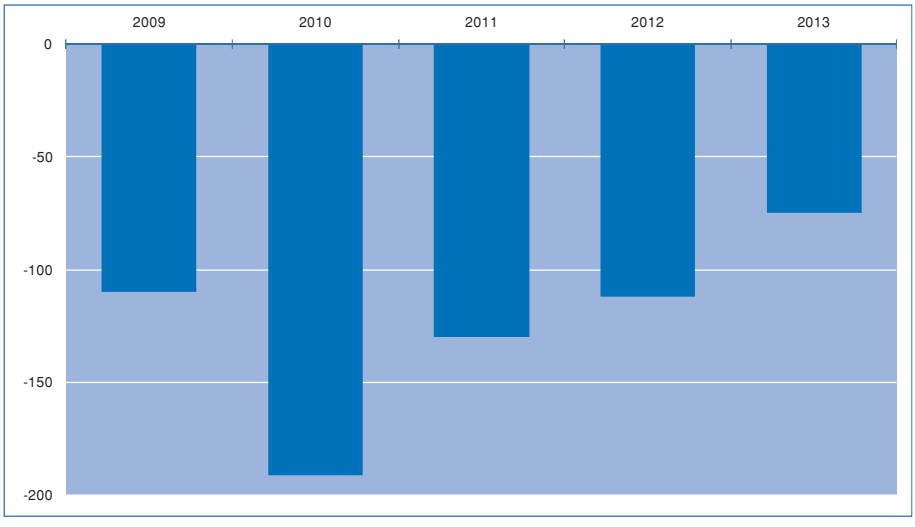
Source: OECD (2010), *Going for Growth*, OECD Publishing, Paris and OECD (2010), "OECD Fiscal Consolidation Survey 2010", OECD, Paris; and The Economist, October 7, 2010.

The crisis: a prolonged impact on sub-national governments

The crisis will have a prolonged impact on fiscal relations across levels of government. As SNGs' revenues are often based on the previous year's activity (e.g. shared taxes, equalisation transfers, etc.), most SNGs are expecting the situation to worsen in 2010 and 2011, and even later. In addition, people who lost their jobs first benefit from unemployment insurance, which is a central government responsibility, before moving to social welfare programmes, which often rely on SNGs (Bloechliger *et al.*, 2010). Thus, the rise in SNGs' expenditures will take some time to materialise.

In many OECD member countries, the financial situation of sub-national governments has already worsened significantly (Bloechliger et al, 2010). In Germany, the gross public debt of the *Länder* increased by 8.5% in 2009 to EUR 526 billion. In the United States, states foresee fiscal year 2011 to be the most difficult in modern times, with few improvements expected for 2012. According to the United States Center on Budget and Policy Priorities (CBPP), 44 states are projecting budget shortfalls totalling USD 112 billion for fiscal year 2012 (CBPP, 2011). In early 2011, states' current fiscal conditions remain weak even as the economy appears to be moving in the direction of recovery (CBPP, 2011).

Figure I.8. **State budget shortfalls in the United States (March 2011), millions of USD**



Source: CBPP Survey, March 2011 in McNichol, Oliff and Johnson (2011), *States Continue to Feel Recession Impact*, March 2011, United States Center on Budget Policy and Priorities, available at *www.cbpp.org/files/9-8-08sfp.pdf*.

Local public investment, after being stimulated in 2008-09, is now a target of cuts in many regions and the main adjustment variable of the sub-national budget. Until early 2010, capital expenditure remained relatively high, as many SCGs adopted anti-cyclical measures, often supported by central governments. As stimulus packages are phased out, many OECD member country governments are removing their support to sub-national governments (see Table I.7). Besides, the cuts in national infrastructure programmes mentioned above have an impact on SNGs, given the role they play in the implementation of such programmes. The most drastic examples of sub-national capital spending cuts are in the United States (Gaillard and Vammalle, 2010). However, without the ARRA stimulus, such cuts would have been even sharper.

Table I.6. Reduced central government financial support to sub-national governments

Country	Main measures adopted at the sub-national level
France	The main transfer to SNGs, the *dotation globale de fonctionnement*, to be frozen at the 2010 level until 2013.
Germany	The German Government adopted a new fiscal rule in March 2009 that will limit the cyclically adjusted budget deficit of the federal government to a maximum of 0.35% of GDP and require balanced cyclically adjusted budgets for the *Länder*. It will become binding for the central government in 2016 and for the *Länder* in 2020. A longer transitional period has been agreed for the *Länder* since some are experiencing serious consolidation problems. No borrowing limits have been specified for municipalities and social security funds. To comply with the new fiscal rule, the German Government has to reduce the structural deficit at the federal level by about 0.3% of GDP each year until 2016.
Greece	The government is planning to freeze pay for all public sector workers, at all levels of government
Italy	Italy adopted a EUR 25 billion austerity package for 2011-12, with a cut of EUR 8.5 billion in regions' budgets over the next two years
Korea	Significant spending reductions are planned for the environment (5.3%), general public administration (4.1%) and education (3.6%)
Mexico	The federal revenue sharing (FRS), the main federal revenue available for sub-national entities, decreased by more than 14% in 2009.
Portugal	EUR 100 million reduction in transfer payments from central to local government
Spain	EUR 1.2 billion cut in local and regional governments and EUR 6 billion cut in public-sector investment
United Kingdom	The United Kingdom adopted a severe austerity plan, with GBP 780 million (EUR 680 million) cuts in the Department for Communities and Local Government, and a GBP 1.2 billion (EUR 1.05 billion) reduction in local authority grants.
United States	Many state governments are likely to pull back on transfers to municipalities.

Source: OECD (2010), "The Impact of Fiscal Consolidation at Sub-national Level: Where Do We Stand", GOV/TDPC/RD(2010)8, OECD, Paris.

…and differentiated impact across regions on the longer term

Not only will the crisis have a lasting impact on sub-national finances, but this long-term impact will vary significantly across regions. While the cyclical component of unemployment may abate during the economic recovery, structural unemployment will continue to be concentrated in certain geographical areas. Indeed, in many countries, the rise in joblessness was highly concentrated in specific regions as highlighted in Section i). On the whole, differences in employment growth have been greater within countries than across countries (OECD, 2010i). Long-term challenges linked to population ageing will worsen the problem. The long-term impact of the crisis will therefore persist in regions with structural problems and this will intensify the fiscal challenges these regions will have to address.

Long-term recovery and fiscal consolidation strategies will require national and regional policies tailored to local needs rather than one-size-fits-all policies. 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.

Risks raised by fiscal consolidation for multi-level governance and place-based policies

Fiscal consolidation raises several risks for relations across levels of government and long-term growth. These include:

- **A *cascading effect*, where each level of government transmits the reduction in their budgets to lower levels of government.** Besides an immediate reduction in public service delivery, this continued squeeze on local spending could hamper local and thus national recoveries.
- **The development of a one-size-fits-all fiscal consolidation strategy for all territories**, although fiscal and economic challenges vary considerably across regions.
- **Across-the-board cuts in capital expenditures at the sub-national level,** as capital expenditures are the main adjustment variable of the sub-national budget, without distinguishing in the degree of priority of programmes.
- **A focus on *short-term welfare priorities* at the local level**, despite the fact that strategic priorities, such as education, innovation, green growth, require a regional/local approach.

Multi-level governance gaps 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. Most countries and SNGs which are conducting consolidation policies are expected to reach some "visible" results in the near short term. Even if the degree of urgency differs from the management of the stimulus, where sunset clauses were in place for the use of funds, urgency is also a key dimension of fiscal consolidation, given the scale of deficits and the pressure of financial markets. More of than 70% of total consolidation efforts will take place between 2011 and 2012 (OECD, 2011a). Not only the fiscal gap, but also the policy, information and objective gaps run significant risks of worsening, if appropriate co-ordination efforts are not mobilised at all levels of government. The risks are in fact similar to those faced in the management of recovery strategies: focusing on short-term approaches, prioritising urgency rather than strategic thinking, underestimating implementation challenges in the absence of *ex ante* dialogue on the preparation and co-ordination of strategies.

Policy co-ordination, transparency and information sharing across levels of government are equally crucial during the consolidation that during the management of the stimulus. It is all the more important to enforce strategies and have them endorsed by local actors and citizens since budget cuts are by nature more difficult to implement than budget increases. MLG for fiscal consolidation may be intrinsically more difficult, since co-ordination has in itself a cost, which can be less acceptable in this context. In addition, the risk of free riding should be monitored. Some regions/SNGs may want to wait for the others to make fiscal adjustment, to avoid the short-term costs of fiscal adjustment. Free

riders would pay less than others the cost of adjustment, thus potentially leading to a war of attrition as each SNG waits for the others to bear the costs (Alesina and Drazen, 1991). Co-ordination mechanisms could help reduce incentives and opportunities for free riding, as well as speed up adjustment.

In the short-term, the crisis has encouraged new ways of collaboration across levels of government, but it is not clear whether these institutions will be mobilised to manage fiscal consolidation. The need for speed in budget cuts may entail the risk that MLG co-ordination instruments to be perceived as increasing transaction costs. Although in some cases the clarification of competencies may be needed, different types of MLG institutions have proven their effectiveness in fostering transparency, dialogue across levels of government, and strategic planning during the management of the recovery process. As building these co-ordination platforms takes time, it would be a loss to diminish their role or not mobilise them to manage fiscal consolidation.

Regional development policy[35] may be at risk as well, since the focus on urgency and cuts in public investment may lead to squeezing regional actors. Due to cross-cutting nature of regional policy budgets and the different definitions across countries, it is often difficult to track budgetary spending on regional development. However, it is clear that the crisis and the ensuing fiscal consolidation have led some countries to freeze or cut "explicit" regional development spending, especially in European countries.

The EU Cohesion Policy is in question, with some countries pushing for big cuts in the next programming period 2014-20. In addition, certain European countries already face today the challenge of insufficient matching funds to co-finance EU projects. Indeed, since all EU projects require co-funding (minimum 15%), some countries and regions with severe cuts in capital expenditure are struggling to match funding requirements and in some cases have to delay or cancel planned projects. The fact that borrowing is becoming increasingly difficult for some SNGs amplifies the problem.

Place-based policy approaches and MLG instruments: levers to promote aggregate growth

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." Although the situation contains clear risks for regional development and co-ordination across levels of government, it can also create opportunities for better governance of public investment, as it has become a pre-condition to make better use of scarcer fiscal resources.

Renewed focus on place-based policies and MLG

In a tight fiscal environment, where the budget and monetary policies cannot be mobilised any more, regional development approaches and multi-level governance instruments to support them are amongst the remaining levers to promote aggregate growth (OECD, 2011c). Such a policy approach consists mainly in exploiting **policy complementarities**, which refer to the mutually reinforcing impact of different actions on a given policy outcome.[36] In itself, it does not add costs, except the new co-ordination mechanisms that need to be put in place to manage these complementarities.

The current context has renewed the debate and interest in some countries in regional and place-based policies. While some are reducing their regional focus in an austerity context, others have expressed renewed interest in integrated territorial policy approaches. Australia is moving towards a greater focus on place-based policies and has

created a new ministry in charge of regional policy. In the United States, policies geared towards generating and supporting economic clusters have received increased attention. The United States administration outlined in July 2009 clear principles for a more integrated regional policy and called for a streamlining of redundant federal programmes.

If some countries are getting rid of MLG instruments, others are, on the contrary, seeking to further develop these institutional mechanisms to manage fiscal consolidation. Co-financing mechanisms, with conditions on the use of funding, are relevant incentives for effectiveness. The European Commission, for example, is currently discussing with EU Member States new 'conditionalities' to be attached to the future 2014-20 budget for Cohesion Policy. Some countries are relying on the contractual approach to manage fiscal consolidation. Both for recovery and consolidation, contracts can be instruments that help clarify objectives, funding and enforcement mechanisms and accountability on both sides (OECD, 2007a). For example, in its 2011 Budget Bill, France was considering specific contracts for departments with important financial difficulties, in order to set common objectives between state and regional authorities.

Reconsidering territorial and fiscal reforms

Beyond the short-term pressures, some countries are reconsidering territorial and fiscal reforms to enhance the efficiency of sub-national actors and better involve them in the consolidation efforts. The crisis has had diverging effects on reforms across countries: in some countries, the crisis has tended to freeze reforms, as the focus on urgency has delayed institutional reforms, which often require long negotiations to be adopted. This is, for example, the case in Finland, where the planned reform of the grants system was largely scaled down. Besides, such reforms can be expensive in the short term (need to compensate losers) and increase levels of uncertainty, which may thus not be acceptable in crisis periods (Tompson, 2010). In other countries, the crisis has, on the contrary, contributed to accelerate some reforms. For example, in Italy SNGs were very keen on raising their reliance on own taxes, as the transfers from central government are being cut due to the consolidation efforts. In any case, as countries face fiscal pressures, many countries today are moving back to their reform agenda. The fiscal consolidation context is likely to trigger reforms that increase sub-central efficiency and tighten fiscal discipline (Bloechliger and Vammalle, 2011).

Many OECD member countries are also requiring sub-national governments to participate in consolidation efforts, either by reducing their funding or increasing the control over their budgets. In 2009 the German Government adopted a new fiscal rule as part of a larger reform of the federal structure that will require the *Länder* to ensure balanced cyclically adjusted budgets (Box I.18). In Italy, the 2010 update of the Domestic Stability Pact sets the burden sharing of regions and local governments. Accounting practices have been defined and the harmonisation of the budget rules between central and sub-national governments is in progress in order to enhance the transparency of public accounts and the accountability of sub-central governments. In Spain, the autonomous communities have agreed to present accounts quarterly instead of annually to increase budget transparency.

Territorial reforms, with the objective of achieving economies of scale for public service delivery and investment, are also high on the agenda of certain countries, such as Greece, Finland, France or Korea (Box I.18). Care is needed not to lose sight of the broad strategic picture when designing reforms affecting relations across levels of government. Reforms should not have too narrow of a focus on fiscal consolidation, but need to focus on needs for long-term growth. Reforms such as enhanced inter-municipal co-ordination

have the potential, when properly designed, to combine both objectives of improved public service delivery and better governance of public investment. However, the way the reform is designed (involvement of stakeholders, compensations, communication, etc.) plays a key role in the successful implementation and outcome of the reform, thus deserves significant attention as such (Bloechliger and Vammalle, 2011).

Box I.18. **Examples of multi-level governance reforms adopted in OECD member countries in the wake of the crisis**

Territorial reforms

- **Greece** adopted a law in May 2010 that foresees the reduction of the current 910 municipalities and 104 communities to only 325 municipalities. The law also stipulates the creation of 13 elective regions to replace the current 54 Greek prefectures. In addition to municipal and regional restructuring, the law includes a reform of local and regional public administration aimed at enhancing transparency, productivity and efficiency. This includes the reduction of local government employees by 50% from 50 000 to 25 000 (Ministry of Finance of the Hellenic Republic, 2010).
- **Finland** has introduced a financial carrot for mergers of municipal governments. It is expected that at least until 2013, amalgamation will have a voluntary character. Although the financial crisis did not precipitate the reform, it influenced its implementation.

Fiscal reforms

- **Germany.** In 2009 the German Government adopted a new fiscal rule as part of a larger reform of the federal structure that will require the *Länder* to ensure balanced cyclically adjusted budgets. The rule will become binding in 2020. In addition to the new fiscal rule, the German Government created a Stability Council (*Stabilitätsrat*) composed of the Minister of Finance, the Minister of Economics and the finance ministers of all the *Länder*. To avoid future budgetary crises the Stability Council will regularly monitor the budgets of the federal and *Länder* governments. It is meant to function as an early warning system. If a budget risks falling into distress, the responsible government develops a consolidation plan with the Stability Council, and the council monitors the implementation of the consolidation plan on a semi-annual basis.
- **Italy.** The government has moved ahead in implementing the fiscal federalism reform in line with the enabling act approved in May 2009. Such law has defined crucial aspects related, *inter alia*, to public-finance co-ordination between the central government and regional and local governments, the harmonisation of public budgets, the determination of standard funding requirements and costs, the reform of regional and local government's own taxes and tax-sharing system

Source: OECD country notes (2010) and Bloechliger and Vammalle, forthcoming.

Learning from the crisis: key guidelines for governing public investment strategies across levels of government

In a context where the room for manoeuvre is highly constrained, it is even more important to make the most of public investment and to learn from what has worked or not worked in the management of stimulus packages. Investment decisions are usually highly complex, involve long-term operational costs that need to be fully assessed, and shape regional and national economies for the future. The crisis has highlighted the

challenges of investment decisions taken in situations of urgency, when speed becomes the only selection criteria. Requirements related to the use of investment funding have had a strong influence on the type of projects selected across levels of government.

If many countries and regions have reduced planned levels of capital expenditures, a significant number are trying to preserve some policy areas to support economic growth, in particular education, research and development, and infrastructure (see Box I.19 and OECD, 2011a). Securing long-term growth through appropriate investment at the national and regional levels, in particular for innovation and green growth, is critical, in particular to restore trust. Successful deficit reduction needs not only to be "defensive" but also needs to have "offensive" elements (infrastructure, R&D) that may strengthen future economic development (OECD, 2010d). In addition, from a political economy of reform point of view, spending cuts tend to be better accepted when they are balanced by positive objectives such as long-term development and investment.

Box I.19. **Overview of current investment strategies in selected OECD and G20 countries (in September 2010)**

- **Australia.** In its 2009-10 budget, the Australian Government invested around AUD 22 billion in long-term economic infrastructure projects, which are expected to support employment in the short term and boost economic growth and productivity in the longer term. In addition, the Australian Government declared that it would mobilise three nation-building funds, the Building Australia Fund (BAF), the Health and Hospital Fund (HHF) and the Education Investment Fund (EIF) to finance major economic infrastructure projects and capital investments in health and education. In July 2010, the Australian Government announced a new Minerals Resource Rent Tax (MRRT) on iron ore and coal as well as an extended Petroleum Resource Rent Tax on all Australian onshore and offshore oil and gas projects. Some of the revenue from these sources will be used to fund further infrastructure projects.
- **Canada.** The majority of stimulus measures will end in the spring of 2011, although there are exceptions, including the four main infrastructure programmes that were extended until 31 October 2011. Infrastructure programmes that are part of the government's long-term infrastructure plan, Building Canada, will continue to provide funding to provinces and territories, as well as municipalities (which existed prior to the extraordinary stimulus effort) in the coming years. In addition, the Canadian Government has committed to make the Gas Tax Fund for municipalities (a component of Building Canada) permanent at CAD 2 billion beyond 2014.
- **France** launched a strategy in December 2009 for "investments for the future" amounting to EUR 35 billion, to finance long-term growth priorities, in particular green energy, broadband and higher education. Calls for projects started in 2010 and projects are selected on the basis of competition.
- Although **Korea** plans to reduce spending in industry, SMEs and energy, where much of the fiscal stimulus had been concentrated, other areas, in particular R&D, will receive an additional 7.1% increase in spending, in line with Korea's 2008 mid-term plan to boost public R&D by 50% between 2008 and 2012. The investment will be concentrated in basic science, new growth engines and green technologies, i.e. key levers for long-term growth.

Box I.19. **Overview of current investment strategies in selected OECD and G20 countries (in 2010)** *(cont'd)*

- **Spain.** The State Fund for Local Investment was not designed to allow for forward-looking investments that would have helped to shift the Spanish economy away from its strong reliance on the construction sector. The Spanish Government identified this gap and, recognising the need to advance the modernisation and sustainability of the economy, it launched a new Local Investment Fund in 2010. The available funding amounts to EUR 5 billion and will be directed at projects that promote long-term objectives, including environmental sustainability and vocational training. It expects to create around 280 000 jobs.
- Although the **United Kingdom** has a severe austerity plan for 2011, the government has maintained a few investment programmes, including the science budget, a new cross-London rail link and plans for a high-speed rail line from London to the north.
- **United States.** On 7 September 2010, President Obama announced a package of roughly USD180 billion in expanded business tax cuts and infrastructure spending. Congress would need to approve any such new package, but is not certain to do so. This package would include a USD 50 billion investment in America's transport infrastructure to spur the economy and create jobs. The plan builds upon the infrastructure investments that were made through the Recovery Act. The proposal calls for investments over six years to rebuild and modernise 150 000 miles (241 350 km) of roads, 4 000 miles (6 430 kilometres) of railways and 150 miles (241 km) of runways. The plan also proposes to set up a government-run infrastructure bank to leverage federal money with state, local and private sector investments to finance projects and focus on the smartest investment.
- **EU countries.** The president of the European Commission unveiled plans on 7 September 2010 to raise new sources of finance to fund EU infrastructure projects, notably the establishment of EU "project bonds" issued in conjunction with the European Investment Bank (EIB). The bonds would be used to fund major infrastructure projects – such as the construction of new dams, bridges, railways and ports.
- **Brazil.** In March 2010, Brazil launched phase two of the Growth Acceleration Programme (PAC 2), with investments of USD 526 billion (BRL 958.9 billion) for the period from 2011 to 2014. PAC is a strategic investment programme that combines management initiatives and public works. In its first phase, launched in 2007, the programme called for investments of USD 349 billion (BRL 638 billion), of which 63.3% has been attributed. Like the first phase of the programme, PAC 2 focuses on investments in the areas of logistics, energy and social development organised under six major initiatives: Better Cities (urban infrastructure); Bringing Citizenship to the Community (safety and social inclusion); My House, My Life (housing); Water and Light for All (sanitation and access to electricity); Energy (renewable energy, oil and gas); and Transport (highways, railways, airports).

Source: OECD country notes 2010 (see Part II).

Since these strategies constitute among the few levers to enhance aggregate growth, countries and regions cannot afford to get their public investment wrong. Learning from the crisis, it is possible to identify a common set of good practices for the design and implementation of public investment strategies across levels of government. These good

practices can indeed apply in a context of growth or recession, as in both contexts governments need to make the most out of public expenditure, to support growth and restore trust with citizens. These guidelines are interdependent, as the isolated effect of each of these principles may be significantly reduced compared with a whole-of-government approach:

1. **Combine investments in physical infrastructure with investments in soft infrastructure**, such as in human capital and other innovation-related assets, to maximise impact in terms of long-term productivity growth. Infrastructure policy needs to be closely integrated with other sectoral policies such as human capital and innovation as part of a coherent development strategy. Investment funds are likely to work best as part of a multifaceted policy package that makes use of other policy instruments.

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. In addition to national ministries/agencies, regional and local actors have a critical role to play to identify policy complementarities and trade-offs in investment priorities. Clarify the social or growth objectives of investment projects and for the latter, favour selection of projects through competitive procedures. Such calls for tenders should allow local actors to reveal their specific knowledge and development potential. This is particularly needed in times of tight budget constraints.

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. Since the relationship among levels of government is characterised by mutual dependence, countries need to develop co-ordination arrangements to reduce potential gaps or contradictions between policy objectives, fiscal arrangements and regulations across levels of government, which can undermine national strategies for growth. This may imply setting up mechanisms to enhance dialogue across levels of government or specific instruments such as contractual arrangements. Co-ordination takes time, involves a learning curve and has different types of costs (transaction, opportunity, monitoring costs), but when properly designed and implemented, long-term benefits of co-ordination should outweigh its costs.

4. **Build transparent management process to improve the selection and implementation of investment projects at all levels of government**. Prevent waste and corruption in investment projects from the selection process throughout the tendering until the contract management and payment. Maximise transparency at all stages of the procurement cycle, and establish clear accountability and control mechanisms. 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. Accountability processes should encompass different stakeholder views (citizens, NGOs, technical experts, etc.) regarding the use of funding, without compromising reactivity in the investment decision.

5. **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. Fragmented or poorly integrated investment

may fail to capture the full benefits. This would avoid the proliferation of small-scale projects with low economic returns.

6. **Rely on cost-benefit analysis and strategic environmental analysis to help inform and prioritise investment decisions.** Cost-benefit analyses should state whether the decision is made on the basis of economic benefits or qualitative goals. Because infrastructure investment tends to involve large-scale, frequently irreversible projects, it is crucial to ensure that existing stocks are used efficiently before investing in new capacity. Operational costs of the maintenance of investment over the long-term, which are often under-estimated, should be fully assessed from an early stage in the decision-making process. Assessments of the long-term consequences of investment decisions need to be incorporated into budget systems at all levels of government.

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 and overcome any tendency by spending agencies/ministries to consider only a limited set of investment options. Care is however needed in the financing of such funds, as they risk becoming pro-cyclical.

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. Enhance coherence across sectors in regulation targeting cross-cutting outcomes such as green growth, innovation and risk management. Ensure independence of regulators; which helps establish a stable, credible and transparent framework for 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. Robust local public employment systems, with transparent recruitment and remuneration rules, are needed. Developing the ability to manage relations with banks and private actors is crucial for the implementation of public investment. Local capacities to design appropriate investment strategies must be sufficiently developed, in particular regions' capacity to diagnose their competitive advantages and challenges

10. **Bridge information gaps across levels of government.** More work is needed in most countries to better track investment at regional and local levels in terms of spending and overall impact. 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.

In future work, developing more precise indicators for each of these guidelines could help to monitor the challenges and progress of countries and regions when managing public investment across levels of government. Since the design and the implementation of public investment strategies determine much of their effectiveness, improving their governance can contribute to maximising their impact.

Notes

1. Moreover, the latter can appear as current expenditures in government accounts (such as acquisition of software or training of human capital). Public-private partnerships (PPPs) are also not necessarily counted as public investment.
2. Capital expenditure is measured as the sum of the gross fixed capital formation (GFCF) and capital transfers payable to business or households.
3. Here measured as the annual change of the share of gross fixed capital formation in GDP.
4. Sub-national governments represented 32% of public spending and 22% of public revenues in the OECD in 2008.
5. This share is as high as two-thirds in some federal and regionalised countries.
6. In the Australian Capital Territory it is around 3 700 US PPP dollars more than four times the country average. Similar ranges in capital expenditure per head are found in Canada, Italy and the United States (OECD, 2011, forthcoming).
7. The impact of physical infrastructure on output is difficult to pin down and the direction of causality hard to determine empirically. Many studies point out that the relation between infrastructure investment and economic growth, even if positive, can vary greatly according to the policy framework. In addition, few countries publish estimates of the capital stock in infrastructure sectors (OECD, 2009a).
8. Measured as the sum of gross fixed capital formation (GFCF) and capital transfers.
9. Measured as the sum of gross fixed capital formation (GFCF) and capital transfers.
10. New York Times, 2010
11. Overall, there is a consensus that stimulus packages have protected the economy from a complete collapse and have helped to support and create jobs. Estimates from prominent economic forecasters indicate that GDP growth in the United States in the second quarter of 2009 would have been two to three percentage points worse without the economic stimulus (OECD, 2010c).
12. The issue of the "perfect size" of municipalities – one that allows for both optimal democratic representation/participation and management efficiency – is a long-standing economic debate.
13. 52% of the reimbursement of VAT went to municipalities, 30% to departments and 17% to regions (*Cour des Comptes*, 2010).
14. Spain is divided into 17 constitute autonomous communities which represent Spain's regional level. There are also 50 provinces which are part of the autonomous communities.

15. The MPPS is a biannual survey of each of Michigan's 1 856 units of general purpose local government. A total of 1 204 jurisdictions in spring 2009 and 1 303 in autumn 2009 returned valid surveys (University of Michigan, 2010).

16. In the United States, officials at the Iowa Department of Education expressed concern that recent staff reductions at the state level and a steady loss of experienced business managers in many LEAs across the state could result in less oversight of funds (GAO, 2010a or b).

17. Around USD 2.8 billion of the Recovery Act funds were under contract as of 3 May 2010 and were being administered by local transport agencies (city or county agencies).

18. There seems to be a correlation between city size and access to information: for example, the survey shows that 51% of municipalities with fewer than 1 500 inhabitants feel badly informed about ARRA opportunities, whereas 74% of municipalities of more than 30 000 inhabitants feel well informed.

19. The European Commission has asked member countries to provide information on regional expenditure. This information will start to be available by 2014.

20. The White House Office of Intergovernmental Affairs works closely with state, tribal and local officials to ensure effective government co-ordination, *www.whitehouse.gov/administration/eop/iga*.

21. The European Cohesion Policy provides EUR 347 billion for the 2007-13 period.

22. A survey conducted by the OECD in 2009 with European state territorial representatives (AERTE) showed that existing regional development strategies or contracts have been used to prioritise the public investment contained in the stimulus packages in 11 out of 20 European countries surveyed (OECD, 2009q).

23. See country note on France.

24. Although not specifically created for the recovery strategy, the fund seeks to encourage collaboration between local councils in planning for and financing infrastructure needs.

25. Other measures taken by OECD member country governments included the reassignment of tax revenues to increase the share of taxes allocated to sub-national governments. The Finnish Government, for example, temporarily increased the corporate tax apportionment to local authorities from 22% to 33% of total tax revenue.

26. The temporary measures in the Crisis and Recovery Act could be made permanent.

27. PPPs are ways of delivering and funding public services using a capital asset where project risks are shared between the public and private sectors. A PPP is defined as a long-term agreement between the government and a private partner where the service delivery objectives of the government are aligned with the profit objectives of the private partner (OECD, 2011).

28. Infrastructure accounts for 47% of all PPPs planned and funded in the world since 1985.

29. Overall, Germany is the second largest sub-national bond issuer in the world after US states and municipalities. Other major OECD sub-national bond issuers are Japan, Canada and Spain (Gaillard and Vammalle, 2010).

30. *http://unpan1.un.org/intradoc/groups/public/documents/un-dpadm/unpan038845.pdf.*

31. These reports are all publicly available at *www.actionplan.gc.ca/eng/index.asp.*

32. Thus far two progress reports have been released and clearly indicate the amount of approved funding and the amount of funding paid out.

33. A challenge highlighted in the UN survey is that the quality of data collected differs across regions and localities. In the United States, for example, the geographic information systems used by state and local governments are not the same and are frequently incompatible (UNPAN, 2010). In the context of the recovery, this showed the need to harmonise the basic level of information collected across sub-national governments.

34. *www.federalreporting.gov.*

35. Regional development policy is a multi-faceted process, which aims to better target national, regional and local policy mixes to local needs, to enhance regional and aggregate economic growth and citizens' well-being. Regional development policy is complex. It engages actors from different ministries, different levels of government, the private sector and different parts of civil society. All bring important but differing assets, perspectives, professional norms, and strategies to bear on issues with a territorial dimension. There is no single indicator or objective for an effective regional policy, as it refers mainly to synergies and complementarities across different policies and programmes.

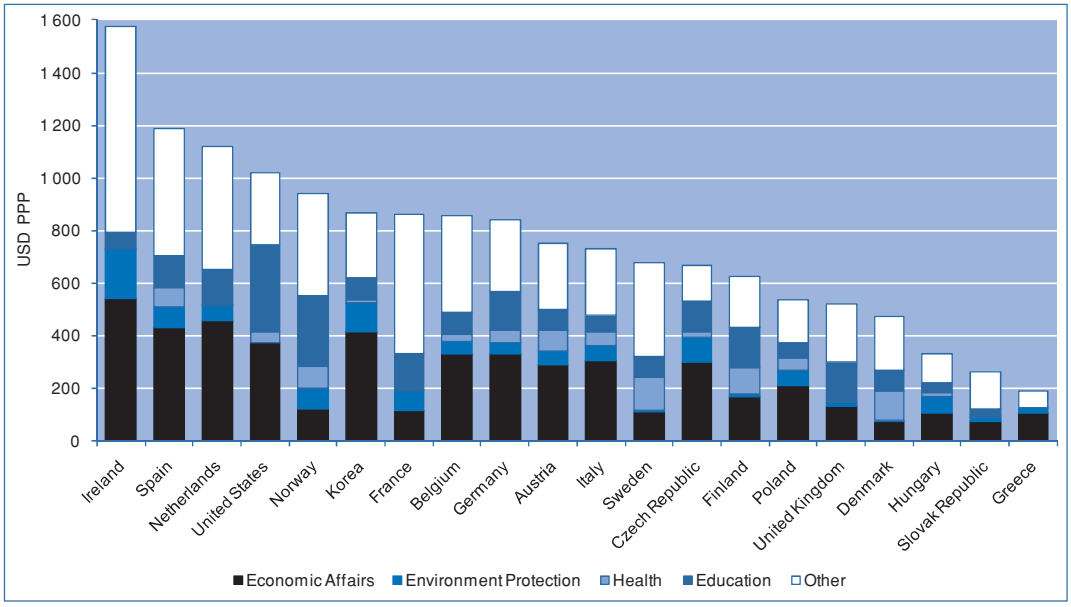
36. The concept of policy complementarities refers to the mutually reinforcing impact of different actions on a given policy outcome.

Annex I.A1

Sectoral breakdown of sub-national investment

Sub-national government capital expenditure is mainly directed to economic affairs, education, environment and health. Together these four sectors represent more than 50% of the total capital expenditure carried out by sub-national governments. However, there are significant variations across regions on the sectoral breakdown of sub-national capital expenditure.

Figure I.A1.1. **Sub-national governments' capital expenditure per capita, 2008**

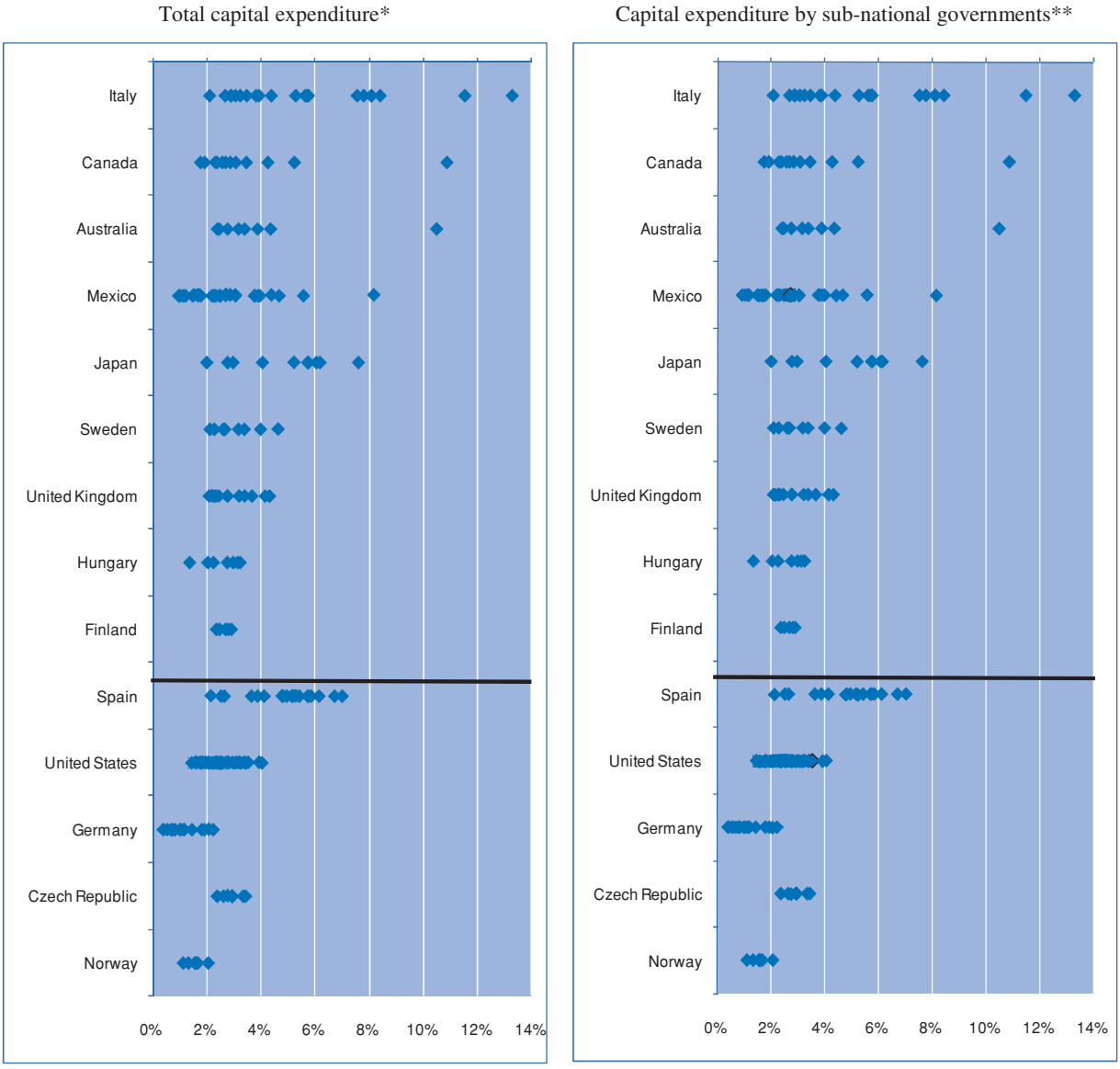


Source: OECD General Government Accounts (2008).

Annex I.A2

Regional variations in sub-national capital expenditures

Figure I.A2.1. **Capital expenditure in regions (TL2) as a % of GDP (latest available year)**



* Capital expenditure in regions by all level of governments. Capital expenditure in Australia, Canada, Finland, Japan and Sweden is measured by gross fixed capital formation.

** Capital expenditure in regions carried out by sub-national governments. Capital expenditure in Germany and Norway is measured by gross fixed capital formation.

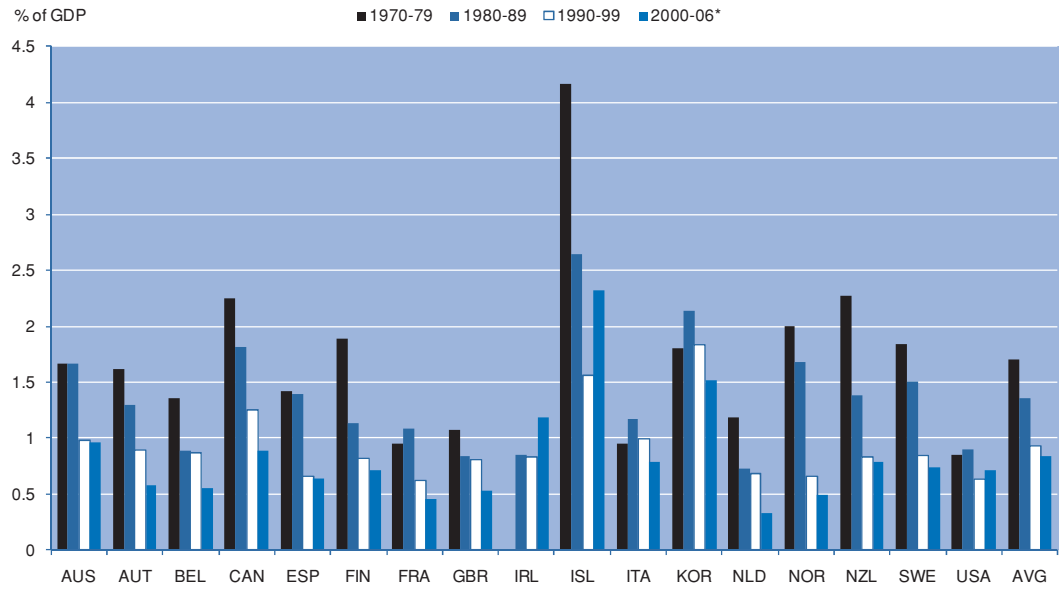
Latest available years: 2005 for Japan; 2006 for Canada; 2007 for Czech Republic, Finland, Germany, Italy, Norway, Spain, Sweden and the United Kingdom; 2008 for the United States and 2009 for Australia.

Source: OECD Regional Database; OECD (forthcoming), *OECD Regions at a Glance*, OECD Publishing, Paris.

Annex I.A3

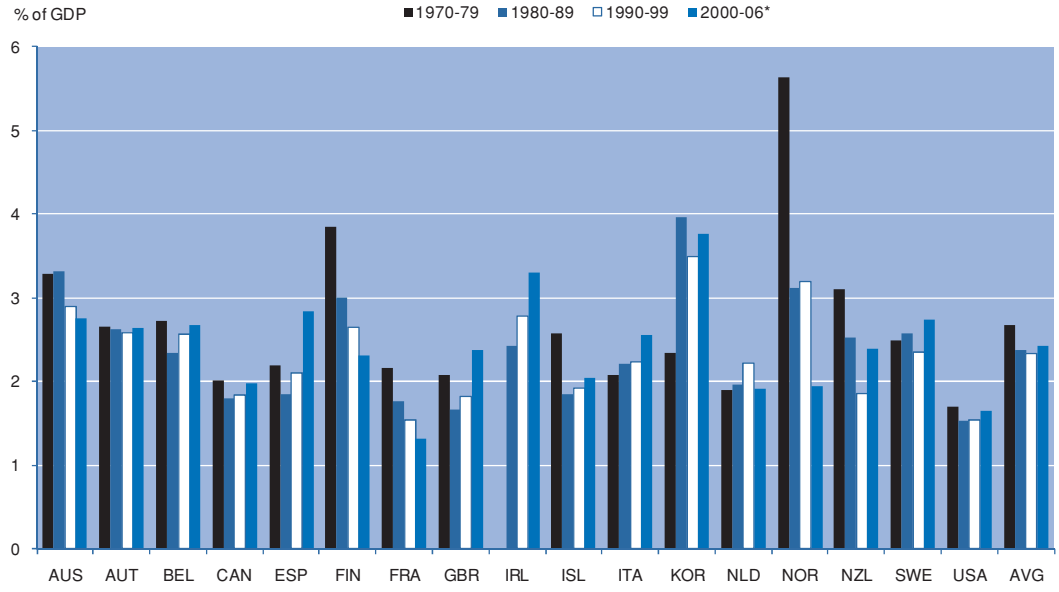
Sectoral breakdown of investment: trends since the 1970s

Figure I.A3.1. **Electricity, gas and water**



Source: STAN in Sutherland, D. *et al.* (2009), "Infrastructure Investment: Links to Growth and the Role of Public Policies", *OECD Economics Department Working Papers*, No. 686, OECD Publishing, Paris.

Figure I.A3.2. **Transport, storage and communication**



Source: Ibid.

Annex I.A4

Features of crisis-response websites selected in the UN survey 2010

Countries	Objectives					Tools		Draws on existing site
	Public scrutiny of funds	Management	G2B	Social protection	Feedback	Geo-referencing	Social media	
Australia *www.economicstimulusplan.gov.au* Breakdown of stimulus plan and tracking stimulus projects at local level. Enables interactivity (ask a question). Links to sub-national websites of similar scope.	x		x	x		x	x	
Canada *www.actionplan.gc.ca* Outlines Canada's Economic Action Plan.	x		x	x		x	x	
France *www.relance.gouv.fr* Details projects being carried out under stimulus package.	x		x	x		x		
Germany *www.fuer-alle-da.de* Ministry of Finance. Details of financial crisis and bank bailouts. Page allows citizens to ask questions online and the answers are also displayed online.	x		x	x				
Korea *www.mosf.go.kr/recover_eng* Section of Ministry of Strategy and Finance website. Sections on general policies, fiscal policies, employment, industries and green growth actions to overcome the crisis.	x							
Spain *www.plane.gob.es* Plan "E" is the government website on economic stimulus and employment, in five languages to reflect the country's linguistic diversity. Pages provide information on courses of action, video interviews with public officials, and links to local-level project information.	x		x	x	x		x	
Sweden *http://regeringen.se/sb/d/11577/a/120213* Overview of stimulus measures.	x							x

Annex I.A4

Features of crisis-response websites selected in the UN survey 2010 *(cont'd)*

Countries	Objectives					Tools		Draws on existing site
	Public scrutiny of funds	Management	G2B	Social protection	Feedback	Geo-referencing	Social media	
United States								
www.recovery.gov The government's official website to "track the money" with data related to United States Recovery Act spending. For citizens to track the development of the recovery for greater transparency and accountability.	x	x	x	x		x	x	x
www.usaspending.gov Details federal spending including that related to stimulus funds. Includes IT Dashboard to follow investments in the information technology sector. The dashboard is considered to be one of the most innovative tools to enhance public scrutiny of government spending.	x	x				x		

Source: Compiled from UNDP 2010 Report on e-government, *http://unpan1.un.org/intradoc/groups/public/documents/un-dpadm/unpan038845.pdf.*

Annex I.A5

Reduced central government financial support to sub-national governments (2011-12)

Country	Main measures adopted at the sub-national level
France	The main transfer to SNGs, the *dotation globale de fonctionnement*, to be frozen at the 2010 level until 2013
Germany	The German Government adopted a new fiscal rule in March 2009 that will limit the cyclically adjusted budget deficit of the federal government to a maximum of 0.35% of GDP and require balanced cyclically adjusted budgets for the *Länder*. It will become binding for the central government in 2016 and for the *Länder* in 2020. A longer transitional period has been agreed for the *Länder* since some are experiencing serious consolidation problems. No borrowing limits have been specified for municipalities and social security funds. To comply with the new fiscal rule, the German Government has to reduce the structural deficit at the federal level by about 0.3% of GDP each year until 2016.
Greece	The government is planning a freeze pay for all public sector workers, at all levels of government.
Italy	Italy adopted a EUR 25 billion austerity package for 2011-12, with a cut in EUR 8.5 billion in regions' budgets over the next two years
Korea	Significant spending reductions are planned for the environment (5.3%), general public administration (4.1%) and education (3.6%)
Mexico	The federal revenue sharing (FRS), the main federal revenue available for sub-national entities, decreased by more than 14% in 2009.
Portugal	EUR 100 million reduction in transfer payments from central to local government
Spain	EUR 1.2 billion cut in local and regional governments EUR 6 billion cut in public-sector investment
United Kingdom	The United Kingdom adopted a severe austerity plan, with GBP 780 million (EUR 680 million) cuts in the Department for Communities and Local Government, and a GBP 1.2 billion (EUR 1.05 billion) reduction in local authority grants
United States	Many state governments are likely to pull back on transfers to municipalities

Source: OECD (2010), "The Austere Fiscal Environment and its Lasting Impact on Regions", GOV/TDPC(2010)16, OECD, Paris; and OECD (2010), "The Impact of Fiscal Consolidation at Sub-national Level: Where Do We Stand", GOV/TDPC/RD(2010)8, OECD, Paris.

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Part II

Country cases

Country notes were developed for eight selected OECD countries in which public investment measures have played a significant role in the recovery strategies launched in response to the crisis, and representative of different institutional frameworks in the OECD (Australia, Canada, France, Germany, Korea, Spain, Sweden and the United States).

Country cases aim to: i) assess the degree of implementation of public investment packages across levels of government, the obstacles that were met and the governance instruments that have facilitated implementation; ii) extract lessons for multi-level governance of public investment in a longer term perspective and changing contexts.

In order to facilitate comparability, country notes are all structured in the same manner, addressing the following four key points: i) the Macro dimension – impact of the crisis; ii) the design of the public investment scheme and involvement of sub-national governments; iii) implementation of the public investment strategy; and iv) obstacles to effective multi-level governance and lessons learned.

The purpose of the country cases is not to make an extensive assessment for each country, nor to assess the economic impact of investment plans; rather, it is to provide a quick snapshot of the way investment strategies have been designed and implemented across levels of government, the key challenges that have been met and the good practices that can be identified.

Country notes were written in the second half of 2010 and reviewed by respective countries in early 2011. A full assessment will only be possible once investment stimulus measures expire and data on the use of funds are entirely available.

Chapter 1

Australia

Macro dimension

Impact of the economic crisis on the Australia economy

The Australian economy weathered the crisis better than other economies in the OECD area. Australian GDP grew by 2.41% in 2008 and 1.24% in 2009, at a time when most other OECD economies were going through a deep recession. GDP growth was 2.6% in 2010 and is expected to reach 3.5% in 2011 (Economist Intelligence Unit, 2010). Yet, some regions in Australia, especially those with a focus on mining, tourism and manufacturing, seem to have suffered disproportionately from the crisis.[1] Australia's overall very robust position was owed to a comparatively less exposed banking sector, the government's fiscal surplus and swiftly introduced stimulus measures, the Reserve Bank of Australia's monetary response as well as China's continued demand for Australian commodities.

By international standards, Australia experienced a relatively shallow downturn during the global recession, with the unemployment rate increasing from a low of 4% in February 2008 to a peak of 5.8% in mid-2009. A key factor in the strong performance of Australia's labour market has been its flexibility. During the downturn, many employers appear to have reduced staff working hours in preference to job shedding. The result was a relatively mild slow down in employment growth accompanied by a substantial fall in average hours. This relatively mild deterioration and subsequent recovery in the labour market allowed Australia record an unemployment rate of just 5% in January 2011.

Stimulus measures

To stabilise financial markets, the Australian Government guaranteed deposits as well as wholesale funding for banks regulated by the Australian Prudential Regulation Authority (APRA). In addition, the government launched a number of measures to stimulate the domestic economy that totalled AUD 77 billion (Australian Parliament, 2010). An initial stimulus package, the Economic Security Strategy, launched in October 2008, amounted to AUD 10.4 billion and included one-off payments to pensioners, payments to persons providing care to the elderly and disabled as well as payments for each child in families receiving Family Tax Benefits (ILO, 2010). In February 2009, the government introduced the AUD 42 billion Nation Building and Jobs Plan, which represented around 3.5% of GDP (Australian Government, 2009b).

The Nation Building and Jobs Plan included bonus payments to households amounting to AUD 12.2 billion (representing around 29.0% of the total funding) as well as tax breaks for small businesses worth an estimated AUD 2.7 billion (accounting for 6.4% of the total funding).[2] The remaining proportion, representing around 63.5% of the total funding, was directed at investments in education, transport infrastructure, social housing and energy-efficient measures for homes. Funding for education infrastructure accounted for the lion's share of investment measures: AUD 16.2 billion, [3] representing over a third of the total Nation Building and Jobs Plan.

Budget deficits

With stimulus measures phasing out and economic recovery underway, Australia's federal budget deficit is expected to decrease from 4.3% in 2009 to 3% of GDP in fiscal year 2010/11 and reach a small surplus (0.25% of GDP) by 2012/13 (OECD, 2010a). Net general government debt is set to peak at less than 6.4% of GDP in 2011/12, i.e. well below the OECD average (Treasury, 2011).

Exit strategy

Since Australia's public finances compare favourably to most other OECD member countries, drastic spending cuts will not be necessary. As robust growth in private sector activity is taking hold, the fiscal stimulus is being phased out as planned. The withdrawal of the fiscal stimulus started to detract from economic growth in the first quarter of 2010. Other measures include holding real growth in spending to 2% a year until the budget returns to surplus and tax increases, most notably a 30% tax on mining profits from iron ore and coal. Since October 2009, the Reserve Bank of Australia has been lessening the degree of monetary stimulus put in place when the economic outlook appeared to be much weaker (Economist Intelligence Unit, 2010).

Design of the public investment measures

Key Australian public investment priorities

The Nation Building and Jobs Plan included investments in both shovel-ready projects and in long-term projects. A sophisticated approach to funding prioritisation was implemented that allowed projects to be grouped into different funding rounds. This made it possible for shovel-ready projects to be brought forward while granting sufficient funding for projects that required longer planning periods. The national government has not made geographical targeting its prime concern. It has focused on key sectors where projects could quickly be undertaken, in particular education infrastructure, social housing and energy efficiency.

As mentioned, the largest share of investment funding was directed at improving and modernising Australia's education infrastructure. Funding for the "Building the Education Revolution" programme amounted to AUD 16 232 million.[4] Australian primary schools received around AUD 14 122 million for investments in new facilities such as libraries and multi-purpose halls and for upgrading existing facilities. All schools in Australia benefited from the so-called "Nation School Pride" programme which foresaw AUD 1 288 million for investments for minor capital works and maintenance projects such as upgrading sporting grounds, infrastructure for students with disabilities or the installation of information and communication technology. The remaining AUD 821.8 million were intended for investments in the refurbishment of science and language centres in secondary schools (Australian Government, 2009: 54).

The "Social Housing Initiative" was the second largest receiver of funds. Total funding amounted to AUD 5 638 million. Around AUD 5 238 million were foreseen for the construction of new social housing. The remaining AUD 400 million were targeted at repair and maintenance works. In addition to the Social Housing Initiative, the Australian Government funded the construction of houses for the Australian Defence forces with AUD 246 million (Australian Government, 2009a: 54).

Approximately AUD 3 239 million[5] were announced for energy efficient measures for homes. The package included assistance for the installation of insulation in homes and a Solar Hot Water Rebate programme. Investments in the upgrading of Australia's road and rail network received funding worth AUD 2 361 million. Funding was directed at programmes improving road safety and the maintenance of regional roads as well as at programmes improving the safety of high-risk rail crossings.

Under the Nation Building and Jobs Plan, the Australian Government also provided AUD 800 million for a limited number of community infrastructure projects (Australian Government, 2009a: 54). These community infrastructure investments represent the continuation of the Regional and Local Community Infrastructure Program (RLCIP), which was launched 18 November 2008.

Table 1.1. Targeted sectors in the national investment recovery strategy

	Infrastructure	Science, R&D and innovation	Education	Green technology
AUD	9.7 billion	2.6 billion	18.2 billion	4.8 billion
% of 2008 GDP	0.82%	0.21%	1.47%	0.39%

Source: Ministry of Finance (2010), answers to OECD (2010), "OECD Questionnaire Response, Making the Most of Public Investment Recovery Strategies, Multi-Level Governance Lessons from the Crisis", OECD, Paris.

Involvement of sub-national governments

On 5 February 2009, at a special meeting of the Council of Australian Governments (COAG) the Prime Minister, state premiers and territory chief ministers signed a "National Partnership Agreement on the Nation Building and Jobs Plan: Building Prosperity for the Future and Supporting Jobs Now", which would facilitate co-ordination between levels of government in the delivery of the medium-term infrastructure elements of the Nation Building package, the "Nation Building – Economic Stimulus Plan (ESP)" (Australian Government, 2009: 10). The COAG is the official inter-governmental forum in Australia (Box 1.1).

Box 1.1. **The Australian Federation and COAG co-ordination**

The Council of Australian Governments (**COAG**) is the main forum for the development and implementation of inter-jurisdictional policy, comprising the Australian Prime Minister as its chair, state premiers, territory chief ministers and the President of the Australian Local Government Association.

Prior to the introduction of the COAG in 1992, **premiers' conferences** served as the peak inter-governmental forum through which the Commonwealth, the states and territories discussed issues of national concern. COAG meetings have been characterised by a high degree of collaborative efforts by state, territory and Commonwealth political leadership as well as agency officials, who participate in COAG decision making through heads of government meetings, ministerial councils and working groups.

The COAG was established in May 1992, but since 2007 the implementation of the COAG reform agenda has been boosted by new Commonwealth leadership and new working arrangements at COAG, including the use of **working groups** of senior state officials chaired by a Commonwealth minister, to identify areas for reform and develop implementation plans.

Under the auspices of the COAG, **ministerial councils** facilitate consultation and co-operation between the Australian Government and state and territory governments in specific policy areas, and take joint action in the resolution of issues that arise between governments. In particular, ministerial councils develop policy reforms for consideration by COAG and oversee the implementation of policy reforms agreed by COAG.

Box 1.1. **The Australian Federation and COAG co-ordination** *(cont'd)*

In 2006, the states established a **Council for the Australian Federation (CAF)**, comprising all the state premiers and territory chief ministers. The CAF aims to facilitate COAG-based agreements with the Commonwealth by working towards a common position among the states as well as common learning and sharing of experiences across states.

In 2008, the COAG agreed to a new **Intergovernmental Agreement on Federal Financial Relations (IGA)**. This agreement increased the financial autonomy of the states, moving from input control to the monitoring of outputs, and rationalising the payments made to the state into five broad areas (health, affordable housing, early childhood and schools, vocational education and training, and disability services). Each of these payment areas are funded by a **special purpose payment (SPP)**, distributed to the states on an equal per capita basis (there is no need to adapt the amounts to the needs and costs of each state, as this is done by the Commonwealth Grants Commission). For each of these payment areas, a mutually agreed **National Agreement** clarifies the roles and responsibilities that will guide the Commonwealth and the states in the delivery of services across the relevant sectors and covers the objectives, outcomes, outputs and performance indicators for each SPP. The performance of all governments in achieving mutually agreed outcomes and benchmarks specified in each SPP is then monitored by the independent COAG Reform Council (CRC) and publicly reported on an annual basis.

The **COAG Reform Council** (**CRC)** is an independent body established by COAG in 2006. It assists COAG to drive its national reform agenda by strengthening accountability for the achievement of results through independent and evidence-based monitoring, assessment and reporting on the performance of governments. The CRC is independent of individual governments and reports directly to the COAG.

In addition, in order to maintain the momentum for reform, the IGA provides a system of **reward payments** (a system that was already successfully used to implement the reform agenda of the 1990's). **National partnership agreements** outline mutually agreed policy objectives in areas of nationally significant reform or to achieve service delivery improvements, and define the outputs and performance benchmarks. **National partnership payments (NPPs)** support the implementation of the agreed reform agenda by providing three types of payments: **project payments**, to support *ex ante* specific projects; **facilitation payments**, to initiate reform in a specific area and lift standards of service delivery, and; **reward payments**, based on the achievement of agreed performance benchmarks. The evaluation of the achievements against the predetermined benchmarks which trigger the reward payments is carried out by the independent CRC.

Source: OECD (2010), *OECD Reviews of Regulatory Reform: Australia: Towards a Seamless National Economy*, OECD Publishing, Paris, doi: 10.1787/9789264067189-en.

The National Partnership Agreement stipulated that the federal government would provide financial contributions to the states and territories, which in turn would implement the agreement. Of the total national spending on public investment, about 56% went to sub-national governments (OECD, 2010b). Contrary to other OECD member countries, sub-national governments in Australia were not required to provide matching funding. The partnership agreement also required the federal government and the states to reach prior consent on any investment programmes under the agreement and to work together in establishing monitoring mechanisms, providing sufficient data to enable thorough evaluation and in identifying best practices. The agreement will expire on 31 December 2012 (COAG, 2010: 4).

For most investment programmes, states and territories received indicative funding from the federal government, which was, however, subject to the submission of suitable proposals (COAG, 2010: 14). The federal government also referred to as the Commonwealth, ultimately decided which proposals would receive funding. To ensure that Commonwealth funding was truly invested in infrastructure measures that otherwise would not have been undertaken, the agreement included benchmarks to assess whether the states and territories maintained post stimulus expenditure levels during the period of increased federal government expenditure. States needed to report on their expenditure to the Ministerial Council for Federal Financial Relations (COAG, 2010: 11). The reporting and monitoring arrangements were built on the new Intergovernmental Agreement on Federal Financial Relations (see Box 1.1). If a state or territory sub-national government did not meet the pre-defined benchmark, the federal government could reallocate the amount to other states and/or reallocate the funding to federal government programmes (OECD, 2010b).

The Australian Government also encouraged local governments to contribute funds or secure partnership funds for projects. Although not specifically created in the context of the recovery strategy, the Australian Government's Local Government Reform Fund aimed at encouraging collaboration between local councils in planning for and financing infrastructure needs.

Incentives to promote public-private co-operation

The Australian Government has simplified public procurement procedures as well as procedures for approval and disbursements to facilitate co-operation between public and private sector actors. It also increased the liquidity of the private sector by guaranteeing wholesale borrowing. More indirectly, the Australian Government improved the liquidity of private sector actors by guaranteeing state and territory borrowing. To promote public-private partnerships, COAG implemented a new National Public Private Partnership Policy as well as new commercial principles (OECD, 2010b).

Transparency

The Council of Australian Governments established an oversight group chaired by a Co-ordinator-General. Its responsibilities include regular reporting to the COAG on the progress of implementing the Nation Building ESP. Progress reports on the Nation Building ESP are published biannually. Thus far two progress reports have been released. These reports clearly indicate the amount of approved funding and the amount of funding paid out. The government also put a web portal online (*www.economicstimulusplan.gov.au/pages/theplan.aspx*) on 25 March 2009. The portal provides key information on the Nation Building ESP and showcases developments in the implementation process. An interactive mapping tool called "My Community" also allows citizens to track approved projects across the country. Actors monitoring the performance include the Council of Australian Governments and the then Minister assisting the Prime Minister for Government Service Delivery (OECD, 2010b).

Specific expenditure and output benchmarks have been agreed upon by the Ministerial Council for Federal Financial Relations of the COAG. States need to report to the heads of treasuries on the activity undertaken against these benchmarks. Monitoring and benchmarking reports are prepared every quarter.

The use of e-government tools to monitor funding has also significantly increased at the sub-national level. Australian states have developed specific web sites to monitor funding and enhance public scrutiny. Some local governments have also implemented innovative approaches, like for example the district of Heathcote, where citizens could present their views on project proposals through an online-based procedure.

Box 1.2. **District of Heathcote**

Citizens in the district of Heathcote were invited to present their views on the allocation of stimulus funding. A specific website allowed citizens to prioritise eligible project proposals, by indicating which projects they believed to be the most worthy of funding. Citizens casted more than 20 000 votes in a short period of time. Citizen groups became actively engaged in canvassing campaigns both online and offline.

Source: UNPAN (2010), *United Nations e-government Survey: Leveraging e-government at a Time of Financial and Economic Crisis*, Department of Economic and Social Affairs, United Nations, New York, NY.

Implementation of the public investment scheme

Funds implemented

As mentioned above, investment programmes funded by the Nation Building and Jobs Plan were largely implemented by Australian states and territories through their agencies as well as through commercial contracts that they put in place. Co-operation between levels of government in the implementation of public investment was high. By September 2010, over 99% of available stimulus funding tracked by the Office of the Co-ordinator-General had been allocated to approved projects.

Table 1.2.Planned implementation of investment

Planned timeframe	Planned implementation of investment (% of total investment package(s))				
Investment to take place by the end of:	Less than 10%	10-25%	25-50%	50-75%	More than 75%
2009		X			
2010				x	
2011					X
2015					X

Source: OECD (2010), "OECD Questionnaire Response, Making the Most of Public Investment Recovery Strategies, Multi-Level Governance Lessons from the Crisis", OECD, Paris.

The **Building the Education Revolution** programme was targeted at both primary and secondary schools across the country. Indicative funding for the **Primary Schools for the 21st Century** part of the programme as well as for the **National School Pride** part was based on student enrolment numbers. However, funding was subject to the submission of suitable proposals. Schools submitted proposals to the authorities of their respective state. States then assessed and prioritised proposals before submitting a list of projects to the Commonwealth for approval. For **Science and Language Labs** in secondary schools, states did not receive indicative funding. Instead funds were allocated through a one-off competitive grant process, in which schools were required to demonstrate need, readiness and capacity (COAG, 2010: 20-25).

For the Primary Schools for the 21st Century programme, as well as the National School Pride programme, projects were prioritised into several funding rounds. The first round of projects under the Primary Schools for the 21st Century programme started no later than June 2009. The construction of projects in the second round was required to start no later than July-August 2009. Under round three, construction needed to commence by 1 December 2009. All projects need to be completed no later than March 2011. The National School Pride programme was structured into two funding rounds. Approximately 60% of all schools were funded under the first round. Proposals for projects in the first round had to be submitted by February-March 2009 and construction was required to begin between April and May 2009. By 31 December 2009 the construction of projects under round one needed to be completed. Roughly 40% of schools were funded under the second round. States and territories were required to submit a list to the Commonwealth for approval between April-May 2009. Projects were expected to commence in late July and be completed by February 2010 (COAG, 2010: 25).

Payments to state and territory education authorities were made based on progress delivering projects. To cover administrative costs associated with running the allocation process and reporting requirements, the Commonwealth provided states' Education Departments and block grant authorities with 1.5% of the total project funding. Ongoing administrative or maintenance costs associated with expenditure were, however, to be borne by the states. Any unspent funds needed to be returned to the Commonwealth (COAG, 2010: 24).

To speed up the implementation process, procedures for reporting requirements were fast tracked. Bilateral agreements between the Commonwealth and each state and block grant authority were concluded, specifying the exact conditions, commitments, timeframes, consequences of non-compliance and reporting arrangements (COAG, 2009: 5).

The Primary Schools for the 21st Century programme was met with a high degree of interest from primary schools. By June 2009, AUD 9.2 billion had been approved for 5 215 primary school projects (AUD 14.1 billion has now been approved for a total of over 10 000 projects). AUD 1.3 billion had been approved by June 2009 for refurbishment and maintenance work under the National School Pride programme (Australian Government, 2009: 37).

The **Social Housing Initiative** constituted the second largest investment programme and was targeted at both the construction of new social housing dwellings and the refurbishment of existing social housing. States and territories received indicative funding on a per capita basis. Like in the case of investments in education infrastructure, funding was subject to states and territories submitting suitable proposals that would meet the requirements of the initiative (COAG, 2010: 13). The Commonwealth made the final decision on which proposals would receive funding. As with the education infrastructure projects, housing projects would also be prioritised into funding rounds. In the first stage, states were required to identify shovel-ready social housing projects that could be brought forward and completed before 30 June 2010. Proposals for funding needed to be submitted to the Commonwealth before 15 March 2009. In the second stage, states determined projects to be funded from 2009-10 onwards. Proposals for these projects needed to be submitted to the Commonwealth by 30 June 2009. The Commonwealth processed the project submissions and provided approval by 30 August 2009 (COAG, 2010: 13-18).

Besides new social housing dwellings, the initiative also included a programme directed at investments in the refurbishment of social housing. States were responsible for identifying social housing dwellings within their jurisdiction that would benefit from maintenance work to increase their effective life and/or improve amenity. By 25 February 2009, states needed to submit proposals with priority to the existing social housing dwellings which were unsuitable for occupation and would otherwise remain unoccupied or sold without additional funding. The Commonwealth provided approval by 1 March 2009 (COAG, 2010: 16).

By June 2009, AUD 1,916 million had been approved for 7 390 new social housing projects. By September 2009, AUD 5.2 billion had been approved for over 19 000 new social housing projects. All of the available funding for maintenance and repairs of social housing dwellings had been approved by June 2009 (Australian Government, 2009: 33).

Public actors in charge of implementing/monitoring

To optimise the delivery of the stimulus package and ensure a co-ordinated management, COAG created a number of new governance institutions. These new institutions included an oversight group within the Department of the Prime Minister and Cabinet. The oversight group, chaired by a **Co-ordinator-General**, was responsible for developing project plans and monitoring mechanisms together with line agencies and state-level authorities. Its tasks also include monitoring the implementation of the Nation Building ESP and preparing reports on the progress of implementation for COAG and other relevant committees. The office of the **Co-ordinator-General** was established by the Australian Government to monitor the implementation of the Nation Building ESP.

The oversight group and the Co-ordinator-General were complemented by the establishment of **national co-ordinators** nominated by relevant line agencies and by **regional Co-ordinator-Generals** nominated by each state (Australian Government, 2009a: 12). Members of the oversight group, line agency co-ordinators and state and territory co-ordinators would meet every fortnight by teleconference and discuss the progress of the plan, share ideas and experiences, and identify and resolve critical issues. Co-ordinators at the line agency level would meet every week (OECD, 2010b).

The heads of treasuries established expenditure and output benchmarks for each of the sectors to receive additional Commonwealth funding. These were agreed by the Ministerial Council for Federal Financial Relations. States would report every three months on activity undertaken in the previous three months against the benchmarks. The ministerial council would then make an assessment against these benchmarks. If a state's expenditure did not meet the benchmark, the federal government reserved the right to make the assessments public; require the state to return the shortfall in expenditure to the federal government, noting that the federal government could reallocate the amount to other states and/or use it for federal government own-purpose programmes; halt further funding for that state for the relevant initiative; or withdraw an amount equivalent to the reduced effort from future federal government payments to the state.

Obstacles and co-ordination challenges across levels of government – lessons learned?

All in all the implementation of the Nation Building Plan seems to have been very successful. Already existing multi-level governance institutions like COAG, in combination with the creation of new institutions, co-ordinated an effective response to

the crisis. Early action combined with investment in critical medium- to long-term economic and social infrastructure provided a "double dividend". This effect was made possible by a solid governance structure that allowed for a sophisticated approach to funding prioritisation. Shovel-ready projects could be brought forward while sufficient funding for projects that required longer planning periods was also granted.

Challenges

Policy gap

The Australian Government, like many other OECD member country governments, faced difficulties in finding shovel-ready nationally significant infrastructure investment proposals. This revealed lack of long-term infrastructure planning, as stated by Ken Henry, Secretary to the Australian Treasury, in March 2010 (Henry, 2010).

Territorial imbalances presented a potential challenge in Australia.[6] Indicative funding for the Primary School programme and the National School Pride programme was based on school enrolment numbers whereas indicative funding for the Social Housing Initiative was allocated on a per capita basis. While neither allocation mechanism allowed for territorial imbalances to be addressed, these were not seen as a significant issue in the Australian context and the allocation methods used were intended to allow projects to be implemented rapidly and a broad geographical spread (e.g. as most suburbs and towns in Australia have a primary school).

Capacity gap

The Commonwealth and the states and territories have had a strong focus on achieving value for money from Nation Building ESP projects, including using well-established government procurement practices and a range of innovative approaches such as the use of independent experts to assess proposals. However, there have been criticisms by external sources of value for money achieved, particularly under the Building the Education Revolution programme. The need to rapidly implement the Economic Stimulus Plan meant that the education authorities in the states and territories were required to fast track all design, application and assessment processes for the Building the Education Revolution (BER) programme.

Individual education authorities were responsible for determining how the programme was delivered within their jurisdictions. Consequently, the education authorities have used different procurement models and delivery processes. There are 22 education authorities involved, including the eight state and territory government school systems and a range of other non-government school systems that deal with the Commonwealth through previously established relationships. Given the different approaches and circumstances of the education authorities, comparing the costs of projects has been complex and some criticisms have likely been based on misinterpretations of data. The use of the previously established arrangements for dealing with the 22 education authorities were critical to the rapid and effective roll-out of the BER. To assess value for money aspects of individual Building the Education Revolution projects, as well as systemic issues, the Australian Government established the BER Implementation Taskforce (the Taskforce). In its August 2010 report, the Taskforce estimated that the overall cost premium for delivering the programme was around 5-6%. This is seen to be a reasonable trade-off for the speed of implementation required to stimulate the economy and save jobs (OECD, 2010b).

Lessons learned

The responsiveness of the Australian Government in the context of the crisis was helped by the fact that a well-developed multi-level governance body – COAG – was already in place and provided a forum for discussion and exchange. Within the COAG framework, the Ministerial Council for Federal Financial Relations proved to be particularly useful. On top of existing structures, the newly created oversight group chaired by the Co-ordinator-General as well as the network of national co-ordinators at the department level and Co-ordinator-Generals at the state and territory level provided a very timely and valuable governance framework for managing the implementation of stimulus measures.

Another positive lesson to be drawn is that encountered obstacles can provide useful feedback for revising stimulus measures. The Australian Government periodically reviewed and adjusted the plan. Adjustments included the provision of an additional AUD 1.515 billion for the Primary Schools programme when it became clear that utilisation of funds was higher than originally expected (Australian Government, 2009a: 19).

Looking forward

In its 2009-10 Budget, the Australian Government invested around AUD 22 billion in long-term economic infrastructure projects. These infrastructure projects are expected to support employment in the short term, while boosting economic growth and productivity in the longer term. In addition, the Australian Government declared that it would mobilise three nation-building funds, the Building Australia Fund (BAF), the Health and Hospital Fund (HHF) and the Education Investment Fund (EIF) to finance major economic infrastructure projects and capital investments in health and education. In July 2010, the Australian Government announced the revised minerals resource rent tax (MRRT) on iron ore and coal as well as the extension of the existing petroleum resource rent tax to all Australian onshore and offshore oil and gas projects. Some of the revenue from these sources will be used to fund further infrastructure projects (OECD, 2010b).

Box 1.3. **Infrastructure Australia**

The Infrastructure Australia Act 2008 came into effect on 9 April 2008 and paved the way for the creation of Infrastructure Australia. Its main task is the development of a strategic blueprint for future infrastructure investments. Infrastructure Australia identifies investment priorities and the policy and regulatory reforms necessary to enable timely and co-ordinated delivery of national infrastructure investment. It works in partnership with states, territories, local governments and the private sector. It also advises Australian governments on how to manage infrastructure gaps and bottlenecks that hinder economic growth.

In the 2008-09 Budget, the government announced the establishment of the Building Australia Fund. Allocations from the Building Australia Fund are guided by Infrastructure Australia's national audit and infrastructure priority list.

The Australian Government also announced that it intends to improve the competitiveness of the private sector by reducing the company tax rate to 29% from the 2013-14 income year. Small business companies (generally those with a turnover under AUD 2 million) will get the tax rate cut a year earlier. More generally, the Australian Government declared that it remains dedicated to ongoing microeconomic and structural

reform. The government is working to create a "seamless national economy" by promoting national markets and harmonising regulation. For example, it has produced, through COAG, national guidelines on public-private partnerships and is working with the states and territories to create single, national transport regulators and legislation for maritime safety, rail safety and heavy vehicles, as well as reforms to heavy vehicle road pricing.

The global financial crisis has accelerated the Council of Australian Governments' (COAG) structural reform agenda. In addition to the already mentioned newly created governance structures, COAG launched an initiative aimed at improving vocational education and training (VET). The global financial crisis has also provided an added impetus to other structural reforms (OECD, 2010b).

Notes

1. Broken Hill (mining), the Gold Coast (tourism) and Geelong (manufacturing), *www.aph.gov.au/house/committee/itrdlg/financialcrisis/report/GFC%20Final%20Report.pdf.*
2. Calculations based on Australian Government (2009: 54). Savings not yet reallocated constitute AUD 39.3 million.
3. Programme funding on announcement was AUD 14.7 billion – additional funding was provided in August 2009. For further information see Australian Government (2009b).
4. Programme funding on announcement was AUD 14.7 billion – additional funding was provided in August 2009. For further information see Australian Government (2009b).
5. Programme funding on announcement for the Energy Efficient Homes Package was AUD 3 859 million – funding was reduced in August 2009 through the discontinuation of the Low Emission Assistance Plan for Renters. Since then, there have been further revisions including the discontinuation of some elements. For further information see Australian Government (2009b).
6. Australia follows a system of fiscal equalisation which is based upon the fiscal capacities of the states and territories. The transfer mechanism to account for fiscal imbalance between the states and territories is through general revenue assistance paid by the Commonwealth. Any fiscal imbalances provided by the stimulus funding will be accounted for through the general revenue assistance over time.

Annex 1.A1

Table 1.A1.1. **Distribution of total stimulus funds**

Major projects	Total stimulus programme funds (millions AUD)
BER – National School Pride	AUD 1 288.9
BER – Primary Schools for 21st Century	AUD 14 122.0
BER – Science and Language Centres	AUD 821.8
Education Investment Fund – Round 1	AUD 580.0
Teaching and Learning Capital Fund – Higher Education	AUD 500.0
Teaching and Learning Capital Fund – Vocational Education and Training	AUD 500.0
Trade Training Centres – Round 2	AUD 110.0
Social Housing – New Constructions	AUD 5 238.0
Defence Housing	AUD 246.0
RLCIP – AUD 250 million Local Councils	AUD 250.0
RLCIP – AUD 550 million Strategic Projects	AUD 550.0
ARTC Rail Investment – 17 projects	AUD 1 200.0
14 Road Projects	AUD 711.0
Black Spot Programme	AUD 150.0
Boom Gates for Rail Crossings	AUD 150.0
Repairs for Regional Roads Programme	AUD 150.0
Social Housing Repairs and Maintenance	AUD 400.0
Total projects	AUD 26 967.7

Source: Office of the Co-ordinator-General (2010), internal figures.

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Chapter 2

Canada

Macro dimension

Impact of the economic crisis on Canada

Due to a sounder banking system, a less-leveraged corporate sector and strong public finances, and significant monetary and fiscal policy stimulus, the Canadian economy weathered the global financial crisis relatively well. The robustness of the Canadian banking sector reflected a conservative risk culture reinforced by effective prudential supervision. Canadian banks were better capitalised and less leveraged than their international peers and mainly engaged in retail banking as opposed to investment activities, all of which are characteristics shared by banks that emerged relatively unscathed elsewhere in the OECD. Even though official liquidity support was available, Canadian banks maintained their ability to raise capital from the markets and did not tap available public borrowing guarantees or require expansion of deposit insurance limits (OECD, 2010).

The recession in Canada was mainly the result of heavy exposures to the U.S. housing and automobile markets. The resumption of positive economic growth in the second half of 2009 followed three quarters of negative growth, beginning with the fourth quarter of 2008. Over the course of the recession, the level of real GDP decreased by 3.3%, the smallest decline of all G-7 countries. Strong growth in domestic demand with a rebound in exports jumpstarted a recovery in the second half of 2009. Real GDP increased by 0.9% in the third quarter, 4.9% in the fourth quarter of 2009 and 5.6 per cent in the first quarter of 2010 before moderating to 2.3 per cent in the second quarter of 2010 and 1.0 per cent in the third quarter of 2010. Although the Canadian household debt-to-income ratio increased to 150 per cent in 2010 Q3[1], the ratio is likely to stabilise or decline as households deleverage in the face of rising interest rates. As fiscal and monetary stimulus is withdrawn and as households deleverage, GDP growth is expected to slow down to 3.5% in 2010 and 2.8% in 2011.[2] The Canadian labour market has completely recouped the jobs lost during 2009, and the unemployment rate has eased from its August 2009 high of 8.7%.

Ontario, Alberta and British Columbia were more adversely affected by the crisis than other Canadian provinces. Ontario was hit hard by the recent global recession and the impact was felt throughout its recovery. Real GDP declined for four consecutive quarters, falling 4.9% from the second quarter of 2008 to the second quarter of 2009. Ontario's real GDP decline in 2009 (-3.6%) was larger than that of the United States, Canada and all other provinces, except Newfoundland and Labrador. In 2009, Ontario represented about 40% of Canadian GDP but accounted for 51% of the decline in Canada's output. This degree of change reflects the relative se of the auto sector in Ontario: 2.6% of provincial GDP in 2009, compared to 0.2% in the rest of Canada. Output in Ontario's automotive sector declined 28.7% in 2009. Also, employment in Ontario posted a steeper decline in 2009 than in any other G7 country, except the United States (-4.3%). Between September 2008 to May 2009, Ontario employment dropped by 256,800. Ontario employment is still down by 12 700 jobs from the pre-recession level. Annually, employment in Ontario dropped 164 300 (-2.5%) in 2009. The unemployment rate reached 9.4% in May 2009, the highest in 13 years. Close to two-thirds of these employment losses were in manufacturing. The impact of the recession is still being felt in several areas in Ontario: the manufacturing sector remains 12.6% below pre-recession levels; auto production is 18.1% below pre-recession levels; and international merchandise exports remain 16.6% below pre-recession levels[3].

Stimulus measures

To stabilise financial markets, the Bank of Canada extended short-term liquidity to financial institutions and gradually lowered its key interest rate to 0.25%. The federal government focused on providing longer-term liquidity, notably through a mortgage purchase program of up to CAD 125 Billion, of which CAD 69.35 Billion was used. The program was allowed to sunset on March 31, 2010 as market conditions had improved markedly since its introduction in October 2008. To soften the impact of the crisis, the federal government provided up to CAD 200 billion in existing and new measures to support the extension of financing to Canadians and Canadian businesses through the Extraordinary Financing Framework. In addition to financial market stabilisation measures, the Canadian federal government launched an economic stimulus plan of CAD 46.355 Billion over two years in March 2009.[4] When combined with stimulus from provincial, territorial, municipal and other partners, the total stimulus provided amounts to CAD 60.384 Billion and corresponds to 4% of GDP. These amounts are over two fiscal years (2009-10 and 2010-11). A number of initiatives in Canada's Economic Action Plan extend beyond these two years (*e.g.* the Green Infrastructure Fund).

Public investment measures, as opposed to other types of stimulus measures, total CAD 17.051 billion, comprising infrastructure components (CAD 14.822billion), investment in infrastructure at colleges and universities (CAD 1.987 billion) and in federal laboratories (CAD 0.242 billion). Infrastructure measures, including additional investments in social housing, account for 32% of the economic stimulus plan[5] . Investments in post-secondary education, and science and technology make up 8.2% of the stimulus plan. Tax cuts and unemployment benefits account for 13.3% and 17.8% respectively. The remaining 28.6% are made up of support measures for industries and communities. Green measures account for approximately 8% of the stimulus plan and are comprised in many of the above mentioned categories.[6]

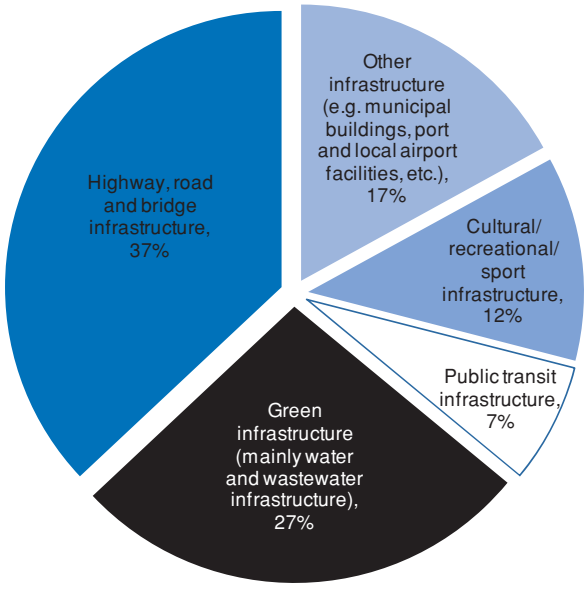
Canada's Economic Action Plan (EAP) provided CAD 5.5 billion for provincial, territorial and municipal infrastructure, representing 30% of the total infrastructure stimulus funding, CAD 4 billion for social housing (22%), CAD 3.8 billion primarily in tax measures to support home ownership and the housing industry (20%), CAD 3.1 billion for knowledge infrastructure (17%), CAD 1.7 billion for federal infrastructure projects (9%) and CAD 515 million for First Nations infrastructure (2.7%). The total stimulus value (i.e. with leverage) of the EAP infrastructure spending amounts to over CAD 28.1 billion over two years, or 1.8% of GDP. In addition, significant new investments to modernise Canada's transport infrastructure were subsequently made in Year 2 of the Economic Action Plan, including support to ferries, federal bridges, and airport and air transport security (see Budget 2010: Leading the Way on Jobs and Growth).

The Canadian economy is also benefiting from a CAD 33 Billion infrastructure plan "Building Canada", which was launched in 2007 as the financial crisis had not yet leaped into view. The tax reductions introduced in 2007 are permanent as are the following two components of "Building Canada": the Gas Tax Fund and the increased GST rebate for municipalities. The other components of "Building Canada" are limited to a seven-year period ending in 2014. These initiatives took effect just at the moment they were most needed, when the U.S. entered recession in early 2008.[7] Moreover, the Canadian federal government's economic stimulus plan announced specific measures to accelerate existing funding under the Building Canada Fund and the Provincial Territorial Base Fund (both

key components of "Building Canada") in order to further increase the amount of infrastructure investment during the 2009 and 2010 construction seasons.

Figure 2.1. **Value of projects under the Infrastructure Stimulus Fund by sector**

CAD 9.97 billion (2009-10 and 2010-11)



* This is the sectoral distribution of investments announced since Budget 2009 (27 January 2009) in provincial, territorial and municipal infrastructure. It captures investments through new and accelerated funding.

Source: Department of Finance (2010), "Canada's Economic Action Plan: Sixth Report to Canadians", Department of Finance, Ottawa, p. 66.

Box 2.1. **The 2007-14 Building Canada Plan**

The CAD 33 billion Building Canada Plan contains:

- the CAD 8.8 billion Building Canada Fund;
- the Gas Tax Fund (CAD 11.8 billion);
- the increased GST rebate for municipalities (CAD 5.8 billion);
- the Provincial/Territorial Base Fund (CAD 2.3 billion);
- the Gateways and Border Crossings Fund (CAD 2.1 billion);
- the Asia-Pacific Gateway and Corridor Initiative (CAD 1 billion); and
- the Public-Private Partnerships Fund (CAD 1.25 billion).

Two of these components (the Gas Tax Fund and the increased GST rebate for municipalities) do not require matching funding.

The Canadian economy is also benefiting from a tax advantage; Canada's Economic Action Plan introduced over CAD 20 billion in new tax relief in 2008-09 and for the following five fiscal years. This will bring total tax relief for individuals, families and businesses from measures introduced since 2006 to an estimated CAD 220 billion over this period.

Budget deficits

Though Canada's budgetary position still compares favourably with most other OECD member countries, recent spending measures and declining tax revenues as a result of the crisis have worsened the country's fiscal situation. The general government deficit of 5.1% of GDP in 2009 was the first one after 12 years of surpluses (Economist Intelligence Unit, 2010: 5). This deficit mostly exists at the sub-national level. While the federal deficit is estimated to be less than 1% of GDP, two of Canada's largest provinces, Ontario and Quebec, have deficits of around 4% of provincial GDP. However, these provincial deficits mostly reflect temporary stimulus measures, notably increased capital investments. Other provinces and territories fare much better. The need to consolidate fiscal positions becomes more apparent when considering the serious fiscal implications of demographic change that will put a strain on governments' balance sheets in the upcoming years.

Exit strategy

Most of the temporary stimulus measures were expected to end by 31 March 2011. In the case of four infrastructure programmes, this deadline has been extended by one full construction season to 31 October 2011. This will permit the construction of unfinished projects to be completed. The extension will not require additional funds from the federal government. Provinces with large deficits should establish deficit targets that can be used to guide budget decisions and most provinces have announced such targets in their 2010 budgets.

Design of the public investment scheme

Key Canadian public investment priorities

As mentioned, infrastructure measures account for CAD 18.8 billion or 39.8% (see above) of the total funding provided by the Economic Stimulus Plan. They include support for home ownership and the housing sector of about CAD 3.765 billion as well as investments in social housing of CAD 2.075 billion and loans to municipalities for housing related infrastructure of up to a further CAD 2.0 billion.

The remaining funding amounts to CAD 8.167 billion and is dedicated to infrastructure other than housing. It includes investments in provincial, territorial and municipal infrastructure of CAD 5.866 billion, investments targeted at First Nations communities of CAD 515 million and investments in federal infrastructure projects of CAD 1.786 billion (see Annex 2.A1).

Investments in provincial, territorial and municipal infrastructure have been mainly directed towards projects in the following categories: highway, road and bridge infrastructure, green infrastructure (mainly water and waste water infrastructure), public transit infrastructure and recreational infrastructure. Projects are typically proposed for consideration and managed by provinces, territories and municipalities, meaning that the

amount of funding dedicated to each category is largely contingent on priorities established by sub-national governments.

The program parameters under the Economic Action Plan programs were similar in some respects to the ones under the Building Canada Fund. The main differences though were that, , with regard to the stimulus funding, programs were more administratively streamlined, and emphasis was placed on directing the funding towards projects that could be built during the 2009 and 2010 construction seasons as well as on rehabilitation, as opposed to new construction. Also, the Infrastructure Stimulus Fund included a few additional investment categories (e.g. municipal buildings) than the Building Canada Fund.

In addition to infrastructure measures, the Canadian economic stimulus plan includes investments in educational and knowledge infrastructure and other science and technology initiatives totaling CAD 3.821 Billion. Around CAD 2.228 Billion are allocated to investments in post-secondary education and research and 1.592 Billion are meant to support investments in science and technology.

Involvement of sub-national governments

In addition to the CAD 46.355 billion in federal stimulus measures, provinces, territories, municipalities and other partners are providing further stimulus of at least CAD 14 billion, for total support of CAD 60.4 billion over two years. In particular, they will provide, at a minimum, an estimated additional CAD 7.3 billion in support of infrastructure investments. Provinces and territories will also provide an additional CAD 2.154 billion to the federal investments in education and knowledge infrastructure.

Over CAD 1.3 billion of the investment in social housing costs will be matched by others including provinces and territories. Of the total CAD 1 billion available to renovate and retrofit social housing, CAD 850 million is for existing social housing projects administered by provinces and territories. This funding, along with CAD 475 million for the construction of new housing for low-income seniors and for persons with disabilities is being delivered through existing arrangements with the provinces and territories which require that they cost-share funding on a 50-50 basis. Provinces and territories are responsible for programme design or delivery of these initiatives. In addition, funding for Northern housing is also being delivered through existing arrangements with the three territories, but does not require cost-matching.

Of the CAD 5.528 billion in stimulus funding over two years for provincial, territorial and municipal infrastructure, CAD 4 billion was allocated through the Infrastructure Stimulus Fund. In general, projects eligible for this funding were identified in discussions between the federal government and provincial and territorial governments. Federal funding only covers up to 50% of eligible project costs for provincial and territorial projects, and municipal projects were mostly cost-shared on a one-third basis.[8] Provincial, territorial and municipal governments and other partners are providing the remaining funding.

Projects under the Infrastructure Stimulus Fund were selected according to criteria that included:

- Projects can involve the rehabilitation of old infrastructure or creation of new infrastructure but they must be incremental in that they would not have otherwise been built within the two years of the Economic Stimulus Plan.

- Construction readiness, as well as the type of work that is needed to prolong an asset's useful life or maintain safety, so that they could be materially completed before 31 March 2011.[9]

The Infrastructure Stimulus Fund was notionally allocated among Canada's provinces and territories on a per capita basis subject to a "use it or lose it" approach to ensure that the stimulus funds are temporary and would be spent by the deadline (the original deadline was 31 March 2011, but this has been extended to 31 October 2011). In particular, the federal government reserved the right to reallocate funds to federal infrastructure or to other provinces, should provinces be slow or unable to take up funding for projects.[10]

As noted earlier, the Government's Economic Action Plan also contained measures to accelerate the approvals of funding under the Building Canada Fund. Further, before they could access the CAD 500 Million Top-Up to the Communities Component of the Building Canada Fund, provinces had to fully commit towards projects their respective shares of the CAD 1.1 Billion in initial funding that was available under the Component (this initial funding was provided in Budget 2007). All provinces were able to do so. Finally, the Government of Canada also offered to accelerate payments under the Provincial-Territorial Base Fund planned over the 2011-12 to 2013-14 period into 2009-10 and 2010-11. Most provinces and territories are taking advantage of this offer.

The funding for educational and knowledge infrastructure was mainly delivered through provincial and territorial governments. Contribution agreements were signed between the federal government and each provincial and territorial government, with the latter then working out contribution agreements with each of the higher education institutions covered under the agreement. There were no provincial or territorial funding allocations under the Knowledge Infrastructure Program. Project funding was awarded on the basis of an assessment of readiness and eligibility to over 500 projects at over 200 institutions across Canada (Industry Canada, n.d.).

For the CAD 2.075 billion investments in social housing, funding was allocated as follows:

- CAD 400 million to build more housing for low-income seniors;
- CAD 75 million for new housing for people with disabilities;
- CAD 200 million for Northern housing (new construction or renovation);
- CAD 1 000 million to renovate and energy retrofit existing federally supported social housing;
- CAD 400 million for new housing and repairs to existing social housing for On-Reserve Housing.

As previously noted over CAD 1.3 billion of the new investment in social housing leverages investments from others, including provinces and territories. Funding allocations between provinces and territories for new construction were per capita based, while funding delivered by provinces and territories for renovation and retrofit of social housing was based on their share of existing social housing units. On-Reserve funding was largely allocated through traditional processes involving First Nation input. In recognition of the distinctive needs of the territories, the Yukon and Northwest Territories each received CAD 50 million while the remaining CAD 100 million was allocated to Nunavut where the need for new housing is greatest.

Up to CAD 2.0 billion in direct low-cost loans to municipalities for housing-related infrastructure is also being provided. To be eligible, projects must reflect an investment in municipal housing-related infrastructure projects, thus contributing to healthier, safer and modern residential communities for Canadians and their families. Only those projects designed to service residential areas (new or existing) may be considered. Funding is being provided largely on a first-come first-served basis and is targeted to projects that are shovel-ready. The types of eligible projects include sewers, water lines and neighbourhood regeneration projects. These low-cost loans significantly decrease the cost of borrowing for municipalities and can be used by them to fund their contribution for cost-shared federal infrastructure programming.

Incentives to promote public-private co-operation

The Canadian government has encouraged public-private co-operation in implementing infrastructure investments. The benefits of partnering with the private sector include the increased access to capital and expertise and the distribution of investment risk among several partners. Typically, federal funds will cover up to 25% of the construction costs of projects undertaken as a public-private partnership (P3). The Canadian government is committed to becoming a leader in P3s. In 2008, the Government created PPP Canada Inc., a new Crown corporation, to spearhead federal P3 efforts and to administer a CAD 1.2 Billion P3 Fund to further develop Canada's P3 market. The P3 Fund, which was launched in September 2009, is the first infrastructure initiative in Canada to focus exclusively on P3 projects. The first two investments under the Fund were announced in 2010 and more investments are expected in the coming months.[11]

Transparency

To provide citizens and private sector agents with as much transparency and predictability as possible, the Canadian Government regularly reports on the implementation of its Economic Stimulus Plan. To date the Canadian Government has issued seven reports, which are all publicly available at *www.actionplan.gc.ca/eng/index.asp*. This constitutes one of the most extensive monitoring arrangements within the OECD area.

Implementation of the public investment scheme

Implementation of the investment scheme

In 2009-10, over CAD 24.9 Billion in federal funding was provided under the economic stimulus plan. Of the CAD 21.4 Billion in available federal funding for 2010-11, 99% is committed.[12]

In particular, the Government has committed all of the funding available for projects under the CAD 4 Billion Infrastructure Stimulus Fund. More than 4,000 projects, representing a total investment of CAD 10 Billion, are benefiting from assistance from this Fund. For the over CAD 2 Billion in social housing investments the report highlights that 100% has been committed and over 9,000 projects were underway or completed to improve social housing and First Nation housing across the country.

As noted in the Sixth Report to Canadians, expenditures under the Infrastructure Stimulus Fund totaled more than CAD 1.1 Billion as of July 31, 2010 and will continue to grow as claims are submitted for work done during the 2010 summer construction season. It is important to note that there is a natural lag between the time when the work is being undertaken, to when a province/territory/municipality is billed for the work, to when they conduct their due diligence review of costs, to when a claim is actually submitted to the Government of Canada for reimbursement. This is a normal situation for infrastructure projects involving multiple partners.

Typically, the allocation of funds to specific projects under the Infrastructure Stimulus Fund is jointly agreed upon by representatives of the federal government and representatives of provincial or territorial governments. Depending on the type of project municipal governments are also consulted.

Impact

According to Finance Canada, the Economic Action Plan is supporting economic recovery in Canada, which began in the third quarter of 2009. Following strong growth of 4.9% in the fourth quarter of 2009 and 5.6% in the first quarter of 2010, real GDP increased by 2.3% in the second quarter of 2010 and 1.0% in the third quarter (Statistics Canada, n.d.). The recovery in output has led to a recovery in jobs in Canada. All of the jobs lost during the recession in Canada have now been recouped, with nearly 467 000 jobs created since July 2009, which represents the trough in employment (Department of Finance, 2010b).

Public actors in charge of implementing/monitoring at central and sub-central level

Organisations such as Infrastructure Canada and the Canada Mortgage and Housing Corporation, Canada's national housing agency, played important roles in the implementation of many of the infrastructure measures included in the Economic Action Plan. The Department of Finance Canada is responsible for the overall monitoring and assessment of the plan's stimulus measures (Department of Finance, n.d.).

Provincial and territorial governments were the main partners in allocating and administering funding under the Economic Action Plan for provincial, territorial and municipal infrastructure. In the case of the Infrastructure Stimulus Fund, the Government of Canada also entered into direct funding agreements with a number of municipalities (e.g. Toronto, Calgary and Edmonton). Similarly, for low-cost loans to municipalities for housing-related infrastructure, the federal government largely entered into loan agreements directly with municipalities (Quebec and British Columbia were the exception where the federal government works with provinces to facilitate loan delivery). Additional agreements were signed with non-profit organisations and other organisations, such as with some of Canada's port authorities and social housing sponsors where the project was under the direct administration of CMHC, the federal housing agency. Agreements were also signed with individual First Nations for infrastructure investments.

Under the Infrastructure Stimulus Fund, Knowledge Infrastructure Program and the social housing investments delivered by provinces and territories for example, quarterly progress reports on the status of projects are submitted by funding recipients (typically, provinces and territories) to the implementing departments (Infrastructure Canada, Industry Canada and CMHC, respectively). The Department of Finance Canada does not play a monitoring role at the programme level.

Federal regional development agencies (RDAs) delivered the Recreational Infrastructure Canada (RInC) component of the EAP, while the Community Adjustment Fund (CAF) component was delivered by the RDAs and the Department of Industry (FedNor).

Main obstacles and co-ordination challenges across levels of government – lessons learned?

Obstacles and co-ordination challenges

Fiscal challenge

The allocation of resources under the CAD 4 billion Infrastructure Stimulus Fund requires matching provincial and municipal government funding. As previously mentioned, the costs of provincial projects in Canada are split 50-50 between the federal government and the respective provincial government. In the case of municipal projects, the federal government, the provincial government and the municipality typically each provide roughly one-third of the cost. In combination with the announcement that eligible projects will at least in part be selected according to the ability of sub-national governments to provide matching funding, this requirement seems to potentially disadvantage financially weak provinces and municipalities.

The impact of the matching requirement on provinces, territories and municipalities has been minimal, as almost all EAP funding has been fully committed. Further, thanks to the matching requirements, the CAD 4 billion Infrastructure Stimulus Fund is generating a CAD 10 billion investment in Canada's infrastructure and is thus achieving a much greater economic stimulus impact. All regions of the country are participating in the initiative.

As well, up to CAD 2 billion is available under the Economic Action Plan in direct, low-cost loans to municipalities through the Canada Mortgage and Housing Corporation for housing-related infrastructure such as sewers, water lines and neighbourhood regeneration projects. These loans will significantly decrease the cost of borrowing for municipalities and can be used to fund their contribution for cost-shared federal infrastructure programming.

For social housing investments, to ensure a quick start to construction, the majority of the funding is being delivered through existing arrangements with provinces and territories. Through amended agreements, provinces and territories cost share federal funding on a 50-50 basis and are responsible for programme design and delivery. This has proven to be an effective means of delivering the funding with all provinces and territories fully participating. Along the same lines, the Government of Canada announced that it may reallocate funds to federal infrastructure or to other provinces should provinces be unable to provide matching funding or prove to be slow in the implementation of projects. Where there have been reallocations, the funding has been spent on federal projects that are located within the province in question.

Policy challenge

As in other OECD member countries, the investment recovery strategy in Canada was implemented to achieve immediate-term sectoral priorities. The recovery plan was implemented using, for the most part, existing federal sectoral programmes and/or provincial/territorial priorities or streamlined programming (especially in health and post-secondary education infrastructure), which provided clear political advantages in that the plan could be implemented rapidly – at least much more rapidly than had it been implemented with purpose-built delivery mechanisms. However, the emphasis on speed in committing and spending funds, although understandable given the crisis, likely precluded embedding the recovery plan within medium- and long-term sectoral and multi-sectoral strategies to maximise its long-term economic impact.

Lessons learned

Overall, the challenge of matching federal funding has remained limited in Canada. Like the infrastructure measures of the Economic Stimulus Plan, much of the "Building Canada" plan is based on cost-sharing arrangements. Only about CAD 1.1B under the CAD 8.8B Building Canada Fund remained publicly uncommitted as of late January 2011. The bulk of this consists of funding set aside for large projects (the Major Infrastructure Component), which are long term in nature. Given that this fund is a seven-year initiative (2007-08 to 2013-14), this is a good result.

Canadian municipalities are required by law to balance their operating budgets. In combination with growing responsibilities and stable revenues, this has resulted in underinvestment in public infrastructure for the past years (Federation of Canadian Municipalities, 2010). The "Building Canada" plan (including the Gas Tax Fund and the Building Canada Fund) and the recent Economic Stimulus Plan attenuated this infrastructure deficit. Yet, the long-term challenge of providing reliable and efficient public infrastructure at the municipal level remains. Canadian mayors called on all parties in the Canadian House of Commons to commit to a new long-term partnership between levels of government to establish a strategy for eliminating the infrastructure deficit, which they estimate to amount to CAD 123 billion. As former Toronto Mayor David Miller pointed out "We shouldn't have to wait for an economic crisis to get governments working together. We need that partnership to fight traffic gridlock, homelessness, climate change, and the infrastructure deficit".

For social housing investments, an approach of amending existing federal provincial and territorial agreements and existing allocation processes for on-reserve housing have proven to be very effective and have contributed to Canada's ability to quickly implement planned stimulus spending.

The Insured Mortgage Purchase Program (IMPP) involved the purchase of existing mortgage backed securities (MBS) comprised of mortgages that were already insured through CMHC or private insurers backed by the government. This enabled the programme to be put in place very quickly and in a cost-effective manner, with no cost to the taxpayer and no additional credit risk to CMHC or the government. The programme helped maintain the availability of longer term mortgage credit in Canada through the global financial crisis, which benefitted Canadian households and the economy. The government authorised up to CAD 125 billion to be purchased through a reverse auction process, however, when the programme ended, only CAD 69 billion was needed.

Notes

1. The continual rise in the Canadian household debt-to-income ratio since the early 1990s corresponds to a period of posted mortgage interest rates trending downward and mortgage discount rates trending higher. Underlying this trend was the Bank of Canada's policy rate which reached one-quarter of one percent in April 2009, the lowest it could effectively go and the lowest it has ever been. With the policy rate nowhere to go but up, household deleveraging is very likely.
2. OECD, Economic Country Review Canada, 2010 forthcoming.
3. *www.statcan.gc.ca/daily-quotidien/100428/dq100428a-eng.htm*; *www.statcan.gc.ca/bsolc/olc-cel/olc-cel?lang=eng&catno=75-001-X201010411148*; *www.fin.gov.on.ca/en/budget/ontariobudgets/2010/ch2c.html; www.fin.gov.on.ca/en/budget/fallstatement/2010/chapter2.html; Statistics Canada and Department of Finance Canada calculations*.
4. Canada's Economic Action Plan, Fifth Report: 58, G20 country Briefs, Canada's Response to the Crisis: 2.
5. Percentage of federal stimulus measures only, calculations based on Canada's Economic Action Plan, Fifth Report: 57-58 (See Appendix)
6. G20 country Briefs, Canada's Response to the Crisis: 2.
7. Department of Finance Canada, *www.fin.gc.ca/pub/report-rapport/2009-1/cepexs-eng.asp*.
8. Exceptionally, the federal government can provide up to 50% of the eligible cost for municipal projects.
9. Infrastructure Canada, *www.buildingcanada-chantierscanada.gc.ca/creating-creation/isf-fsi-guide-eng.html*, 3.
10. *www.buildingcanada-chantierscanada.gc.ca/creating-creation/isf-fsi-guide-eng.html.*
11. *www.buildingcanada-chantierscanada.gc.ca/plandocs/booklet-livret/booklet-livret09-eng.html#newappr01.com.*
12. *www.actionplan.gc.ca/eng/feature.asp?featureId=7.*

Annex 2.A1

Table 2.A1.1. Canada's Economic Action Plan

	Year 1	Year 2	
	2009-10 CAD spent[1]	2010-11 stimulus value[2]	Total
	(millions of dollars-cash basis)		
Reducing the tax burden for Canadians			
Personal income tax relief for all taxpayers	1 885	1 950	3 835
Increases to the National Child Benefit supplement and the Canada Child Tax Benefit	230	310	540
Enhancing the Working Income Tax Benefit	580	580	1 160
Targeted relief for seniors	325	340	665
Total – reducing the tax burden for Canadians	**3 020**	**3 180**	**6 200**
Helping the unemployed			
Strengthening benefits for Canadian workers	1 258	1 550	2 808
Enhancing the availability of training	896	996	1 892
Keeping EI rates frozen for 2010	1 193	2 378	3 571
Total – helping the unemployed	**3 348**	**4 924**	**8 271**
Building infrastructure to create jobs			
Investments in provincial, territorial land municipal infrastructure	852	4 676	5 528
Investments in First Nations Infrastructure	229	285	515
Investments in federal infrastructure projects	943	803	1 746
Support for home ownership and the housing sector	2 606	352	2 958
Investments in social housing for Canadians	1 399	2 676	4 075
Total – building infrastructure to create jobs	**6 031**	**8 792**	**14 822**
Total federal stimulus measures	**24 928**	**21 247**	**46 355**
Assumed provincial and territorial actions	7 062	6 968	14 030
Total Economic Action Plan stimulus)	**31 989**	**28 395**	**60 384**

Notes: 1. Includes estimated values for tax reduction measures. 2. As a result of the extension of four infrastructure programmes, some funds originally planned for 2010-11 will be expended in 2011-12.

Source: Department of Finance (2011), "Canada's Economic Action Plan: A Seventh Report to Canadians", Department of Finance, Ottawa.

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Chapter 3

France

Macro dimension

The impact of the economic crisis

Like other industrialised countries, France was faced with a severe recession in 2008-09. In 2009, GDP fell by 2.2%. The unemployment rate jumped from 8.3% in the last quarter of 2008 to 10% at the end of 2009. Between the first quarter of 2008 and the fourth quarter of 2009, France lost some 600 000 jobs in tradable goods and services (INSEE, 2010). Yet France suffered less from the crisis than the United States, the United Kingdom, Spain, Ireland or Iceland did. In the second half of 2010, recovery was underway. According to forecasts, GDP growth by volume was expected to be up slightly in 2010 then average around 2% in 2011, driven by business investment and exports. The unemployment rate was forecast to peak in the first quarter of 2010 and then trend gradually downwards (OECD, 2010).[1]

The impact of the crisis was not uniform across French regions. According to an INSEE study of May 2010, the northeast was the hardest hit by the recession, and in particular the Franche-Comté, Lorraine, Picardy, Champagne-Ardennes and Burgundy. In these regions, employment losses exceeded 5% from the beginning of 2008 to the end of 2009, compared to 3.6% nationwide. The impact of the crisis was moderate in Ile-de-France (with employment down 2.7% between the beginning of 2008 and the end of 2009, or one percentage point below the national average). The industrial regions suffered most according to the study. By contrast, regions more specialised in tertiary activities were spared the full effect (INSEE, 2010).

Budget deficits in 2010

The fiscal situation has deteriorated over recent decades and the public debt was already high before the crisis struck. Public debt at the end of 2009 was estimated at 77% of GDP (INSEE, 2009). The OECD expected the general government deficit to widen to 8% of GDP in 2010 before declining to below 7% of GDP in 2011 (OECD, 2010). The government is committed to bringing the deficit down to 6% of GDP in 2011 and to 4.6% in 2012. For 2013, the government is targeting a deficit below 3%, consistent with EU criteria. To achieve that objective, the government has launched a series of debates on ways of cleaning up public finances. Public expenditure levels and the fiscal burden in France are already very high by international comparison and the possibilities of eliminating the deficit through discretionary revenue increases are limited (OECD, 2011).

Design of the public investment scheme

Recovery in 2009-10: priority to public investment

To counter the crisis, France has established a recovery plan (*plan de relance*) amounting initially to EUR 26.5 billion (or 1.3% of GDP) over two years (2009-10), focused primarily on investment. That plan, approved by the Inter-ministerial Committee for Territorial Development and Competitiveness (CIACT) on 2 February 2009 in Lyon, comprises three main components:

1. EUR 11.4 billion refunded to businesses to relieve their cash squeeze (early refund of the research tax credit or the VAT tax credit as of the beginning of 2009), and to give them investment funds.

2. EUR 11.1 billion for the government investment programme, to support economic activity and employment, along with a special effort for housing and social assistance, a one-year advance on payments from the VAT Compensation Fund (FCTVA) (EUR 2.5 billion), and a doubling of the zero-interest loan to help individuals purchase housing.
3. EUR 4 billion in additional investments by major public enterprises to modernise and develop railway, energy and postal infrastructure. In addition to the recovery plan, "automatic stabilisers" have also played an important counter-cyclical role.

The plan begins with an exceptional public investment programme in the areas of transport, higher education and research, defence and heritage. It favours investments in traditional infrastructure (e.g. highways, rail lines, bridges and ports, but also the construction or renovation of dwellings, university campuses and the protection of cultural heritage).[2] This programme is complemented by an equivalent effort on the part of major public or para-public enterprises (EDF, SNCF, RATP, La Poste) and supporting loans from the savings funds of the *Caisse des Dépôts et Consignations* (EUR 8 billion).

The initial recovery plan was subsequently reinforced. First, loans were made to automobile makers under the automotive pact concluded at the beginning of 2009. Second, other public players that had not originally been involved were brought in. For 2010, budget allocations were increased by EUR 4.1 billion and tax measures represented a further EUR 1.2 billion, for an expected fiscal cost of EUR 5.3 billion (Court of Auditors, 2010).

Box 3.1. **The FCTVA**

The VAT Compensation Fund is a refund intended to boost activities at the sub-national levels of government.

Its purpose is to offset, at a flat rate (15.42%), the VAT that beneficiaries of the fund, primarily sub-national governments and their agencies, have paid on their physical investment expenses, and which they cannot recover directly through the fiscal route.

Article L. 1 615-6 of the General Code of Sub-national Governments provides that real investment expenses considered for FCTVA compensation for any given year (year n) are those relating to the penultimate year (year n-2). There is thus a two-year lag between the time the local government incurs the expenditure and the payment from the FCTVA.

Source: DGCL (Ministry of the Interior, Overseas Territories and Local and Regional Authorities).

France has based its recovery plan on a swift injection of additional public funds to support the economy, with 75% of those funds to be spent in 2009, the first year of the plan. The recovery plan was deliberately adopted with a short-term focus, for financing shovel-ready investment projects, largely in the public works field. The EUR 26 billion was folded into a single budgetary item, called the "Exceptional Plan for Activity and Employment", to run for two years (2009-10).

The long term

For the longer term, in 2010 France announced a programme of investments for the future ("*grand emprunt"*), amounting to EUR 35 billion, as a lever to mobilise EUR 60 billion in public and private funds for investment in five priority areas (French Government, 2009): higher education and training (EUR 11 billion), R&D (EUR 8 billion), industry and innovative SMEs (EUR 6.5 billion), sustainable development (EUR 5 billion), and the digital economy (EUR 4.5 billion). The participating agencies for implementing this plan are mainly the *Caisse des Dépôts et Consignations* (digitalisation), Ademe (energy, environment, transport), National Research Agency (higher education and research) and OSEO (in support of SMEs, innovation). Implementation of these future investments will be overseen by a General Commissioner of Investment who, under the authority of the Prime Minister, will prepare the government position on individual investment decisions.

To consolidate the recovery and prevent deficits from deepening, the government is proposing a policy of "*rilance*", as the Minister of Finance has called it (combining *rigueur*, "rigour", and *relance*, "recovery"). This strategy places priority on investment with, as a counterpart, strict control of current expenditure, and in particular of government operating expenses.[3] Through the mechanisms in place, and in particular the programme of investments for the future, there will be much more recourse to lending instead of subsidies and grants.

Implementation of the public investment scheme

At the national level

For implementing the recovery plan, France has created a ministry with special responsibility for co-ordinating the response to the crisis. That ministry is charged with monitoring the "1 000 projects" of the recovery plan and co-ordinating with other line ministries and with other levels of government. The Recovery Ministry reports directly to the Prime Minister. The Ministry of Finance is also heavily involved in the design and supervision of the plan. Moreover, a team of "anti-crisis commissioners" was instituted in June 2009, comprising ten persons drawn from various ministers' offices and from DATAR (the Inter-ministerial Office for Local Development and Regional Initiatives), which is responsible for tracking troubled businesses and proposing concrete solutions. France has also set up a team of seven parliamentarians to monitor implementation of the recovery measures in the field.

At the local level

On 16 December 2008, the Prime Minister convened the National Conference of Executives, at which the government presented all the aspects of its recovery plan of relevance to local governments with a view to enlisting their co-operation. Local governments account for more than 70% of non-military public investment. The government was therefore eager to associate them closely with the recovery plan, of which investment was the main lever. One of the key measures for local governments is early refund of the VAT. This mechanism allows those governments to recuperate two years of cash flow for investment spending instead of one year (or EUR 2.5 billion), provided they agree to invest at least as much as the 2004-07 average.

Box 3.2. The interface between the central and local levels in France

France, central government administrations have a direct presence in the departments and regions as an extension of the ministries, in the form of "de-concentrated state services". Placed under the authority of the Prefect, these offices are responsible for implementing state policies locally.

Local governments have the powers specified by law. Within the limits of those powers and the legal framework, they are free to pursue the policies decided by their elected bodies.

Some territorial policies require joint involvement by the state and territorial governments. To that end, the state negotiates "conventions" with them. Those conventions may be open to all local governments in the same category and may have the same timeframe, such as the "state-regions project contracts" (CPER), or they may be one-off conventions such as the "site contracts", reserved to territories that need a special boost for recovery.

This early payment is expected to be of benefit to local governments that have committed themselves to at least EUR 1 in additional capital expenditures, beyond their average spending between 2004 and 2007. If they can demonstrate that, they are guaranteed the refund even if their annual investments subsequently decline. Consequently, while this measure apparently constitutes a cash advance, it is also a subsidy, as it does not affect the pace of transfers in subsequent years.

As in most OECD member countries, local governments saw their fiscal situation deteriorate with the crisis and that deterioration was even worse in 2010 because of the lag effect on local finances (OECD, 2010). In effect, local finances are caught in a scissors movement: they are faced with falling revenues (in particular the decline in proceeds from the inheritance tax) and rising social outlays because of higher unemployment and the introduction of the RSA (*Revenu de solidarité active*, the income benefits for low-wage workers). This is a problem in particular for the departments, half of whose outlays are on social spending. The fiscal squeeze on local governments which began in 2007 and was confirmed in 2008 and 2009, was even tighter in 2010 and is becoming a source of concern. Local governments are likely to have to stretch their accounts even further if the economy does not perform well (Direction Générale des Collectivités Territoriales – DGCL, 2010). In this context, local governments have greatly benefited from the investment support measures of 2009-10, especially the FCTVA, where they have full discretion over the use of its proceeds.

Joint state/local projects

The French recovery plan relies primarily on public investment, and local governments have a major role to play.[4] For the "1 000 recovery projects", state contributions should have a real "leverage effect" on local government commitments. One of the conditions of the state contribution is that the projects must be "shovel-ready",[5] which means that in most cases those governments will already be mobilised to take part in the project.

Part of the recovery plan's investment effort involves moving forward the "state-region project contracts" (CPER) scheduled for 2007-13 (Box 3.3) and the highway development and modernisation plans. Priority has been given to projects awaiting funding in the project contracts. For example, the recovery plan has made it possible to speed CPER investments for expanding the rail system and extending TGV

(high-speed train) service.[6] For the highway system as for the rail system, the recovery plan represents an additional envelope amounting to a half year of the CPER. Moreover, special attention is being paid to overseas investment programmes through the "Special Investment Fund" (*Fonds exceptionnel d'investissement*) and the project contracts, which have been boosted to EUR 135 billion.

Box 3.3. **The state-region project contracts (CPER)**

A state-region project contract (CPER) is a negotiation whereby the state and the region undertake multi-year programming and financing of major projects for creating infrastructure or supporting leading-edge industries. The contracts run for seven years and represent the successors to the planning contracts created by the Law of 29 July 1982. Through the regional prefect, the government agrees with the regional executive on projects for regional development and on each entity's share in the financing. Other sub-national governments (general councils, urban communities) may join a CPER if they contribute to financing the projects that concern them.

While the first contracts were devoted essentially to infrastructure projects and industrial modernisation, subsequent generations of projects have addressed a broader range of issues, including grants for regional innovation and economic development and incentives for geographically defined initiatives. Since the 1990's the budget allocated to these contracts has risen spectacularly – by more than 45% – with each new generation of contracts.

Implementing the CPER involves many agents: the central, regional and local authorities, their representatives and certain intermediation bodies. The planning contract is the outcome of a lengthy process based on the reciprocal engagement of two groups: *i)* the elected local and regional authorities and the "development agents" in the regions (enterprises, associations, etc.), co-ordinated by the regional authorities; and *ii)* the regional prefect, representing the state. The project contracts, negotiated at the regional level, are co-ordinated by the DATAR, which serves as the interface between the ministries and the prefects and prepares the contracts for the Prime Minister's endorsement prior to signature.

The contracts run for seven years, to match the operational programming calendar of the European Structural Funds. To be eligible for European financing, the choice of projects in the CPER must reflect France's obligation to devote 75% of the combined ERDF+ESF envelope to innovation and competitiveness or to sustainable development. They have the advantage, then, of being a tool for multi-level governance and for selecting priority public investments among local governments, the state and the European Union.

Source: OECD (2006), *OECD Territorial Reviews: France 2006*, OECD Publishing, Paris, doi: 10.1787/9789264022669-en; OECD (2010), *OECD Territorial Reviews: Sweden 2010*, OECD Publishing, Paris, doi: 10.1787/9789264081888-en.

Incentives to public-private co-operation

A number of steps have been taken to promote public-private co-operation under the recovery plan, as a way of leveraging public investment. An investment fund was created in October 2008 to help French businesses that needed stable investors to finance their development projects. The state contributed EUR 6 billion to the fund, and, with participation by the *Caisse des Dépôts*,[7] its total resources exceeded EUR 20 billion in 2009. On another front, the *Caisse des Dépôts* has played an important role by making savings funds available as loans (in the amount of EUR 8 billion) to finance public-private partnership (PPP) projects sponsored by local governments or corporations (TGV, renewable energy, university projects, public transport).

The recovery plan contains other measures to encourage PPPs[8] (simplified refinancing, state guarantees) and to make the public procurement code more flexible.[9] One move was to raise the French works contract threshold to the European Community level, increasing it from EUR 206 000 to EUR 5.15 million, which will give the adjudicator greater freedom, and the direct contracting threshold was raised from EUR 4 000 to EUR 20 000, which will make life easier for regular suppliers to local governments (French Government, 2008).

Transparency in implementing the recovery plan

Like most other OECD member countries, France has placed great stress on transparency in the recovery plan's implementation and on regular monitoring of its impact. The special ministry responsible for the plan has established a website detailing all the measures in the plan, ways of accessing it, and expenditure commitments by project and by territory, using an interactive map.[10] Monthly press conferences have been held on the plan's progress and impact.

Implementation as of September 2010

Some EUR 36.4 billion have been injected into the economy, out of a total envelope of EUR 38.8 billion for 2009-10, or nearly 2% of GDP[11] (see Box 3.4). According to the Ministry for Recovery,[12] the recovery plan had been implemented to the extent of 93.7% in August 2010. Between 2009 and 2010, the Court of Auditors estimates that 50.7% of total allocations for those two years were committed in 2009 (Court of Auditors, 2010). Two-thirds of the public investment appropriations under the initial recovery plan were allocated in 2009 (EUR 2.9 billion out of EUR 4.1 billion).

However, expenditure rates vary greatly depending on the sector (Court of Auditors, 2010). At the end of 2009, the commitment rate for infrastructure projects was 65%, for higher education and research projects 52%, for defence 94%, and for heritage projects 66%. Some 1 200 recovery projects were launched in 2009, and 1 500 as of the summer of 2010.

The recovery plan has had a positive impact on employment, although this is difficult to estimate precisely. The minister responsible for the recovery plan believes it will have helped create or save 400 000 jobs in 2009 and 2010. The Court of Auditors, in its September 2010 report, estimated that the plan would create between 18 000 and 72 000 jobs in addition to the jobs saved, over the period of the plan (Court of Auditors, 2010).

Box 3.4. **Summary of the recovery plan's results as of 3 August 2010**

- More than 1 500 state-sponsored projects; EUR 3.868 billion out of EUR 4.1 billion committed.
- EUR 3.6 billion invested by public enterprises.
- 19 540 FCTVA conventions signed with local governments; EUR 54 billion in projected investments, of which EUR 45 billion already in place.
- More than EUR 17.226 billion in the form of tax relief to businesses.
- OSEO has guaranteed more than EUR 4.847 billion in loans to 20 019 enterprises.
- 886 205 payments under the automobile scrapping scheme, amounting to EUR 867 486 million.
- Income tax reductions for 5.1 million households.
- Construction of more than 137 000 housing units financed in 2009-10.
- 115 853 zero-rate loans (PTZ) for a total of EUR 4.398 billion.
- More than 1 185 070 new hirings by TPE ("very small businesses"), thanks to the "zero-charges" (relief from employer social contributions) measure.
- 801 188 subsidised contracts, 500 316 alternating contracts.
- Social Investment Fund (FISO): EUR 1.263 billion already committed.

Implementation of FCTVA reimbursement by local governments

Nationwide, 19 498 sub-national governments (17 160 communes, 90 departments and 23 regions) have signed a convention and are committed to increasing their capital spending above the 2004-07 average (DGFIP, 2009). The FCTVA refund has cushioned the fall in local investment: capital spending as a whole in 2009 remained at the 2008 level (Court of Auditors, 2010). This mechanism seems to have been to the advantage of local governments whose capital spending was already rising. According to the Court of Auditors, 80% of beneficiaries have maintained their spending levels in order to remain eligible for the FCTVA transfer with only one year's lag, without boosting their investments (Court of Auditors, 2010). The Court of Auditors places the total cost of the FCTVA refund at EUR 3.85 billion.

Local governments have taken action on their own, in a manner complementary to the national recovery plan, and have established "anti-crisis" plans, primarily at the regional level. For example, the Pays de la Loire region adopted a EUR 629 million investment plan at the end of 2009 and raised a loan of EUR 80 million. The funds mobilised have increased the pace of regional investment and have allowed the establishment of a regional loan for industrial redeployment intended to provide backing for the most competitive firms. The crisis has in this way highlighted the key role that many regions play as an appropriate level for implementing "anti-crisis" strategies.

Box 3.5. The role of local governments and prefects in implementing the FCTVA

The FCTVA compensates local governments, at a flat rate, for the VAT they pay on a portion of their capital spending. The refund is paid with a lag of two years after the expenditure. Under the recovery plan, the amended budget law for 2009 shortened the FCTVA waiting time to one year for governments that undertook, in a "convention" signed with the prefect, to increase their investment spending in 2009 more than the 2004-07 average.

Participating local governments thus received during fiscal year 2009 the FCTVA refunds due for outlays made in 2007 and 2008. This shortened waiting time will remain in effect for the following fiscal years if the local governments honour their commitment. Local governments are free to choose the investments they will finance under the FCTVA.

To be eligible for the early refund from the FCTVA under the recovery plan, local governments had to sign an undertaking with the prefect for the amount of investment they would make in 2009, but there was no provision to have the prefect determine the choice of investments.

The prefects have had an upstream advisory role in implementing this measure, informing local governments of the precise procedures for obtaining an early refund from the FCTVA, in particular the amount of investment that each municipality would have to make in light of its 2004-07 investment performance.

On this last point, prefects were entitled to assess the investment effort required, in light of specific circumstances (for example, a change to municipal boundaries). Next, prefects had to negotiate and sign conventions with the local governments setting out their commitments (which related only to the overall investment effort, without detailing the planned projects). Lastly, prefects have been responsible for reviewing the files and monitoring the commitments. They also have the power to assess observance of the contractual commitments, in light of specific circumstances. The prefect monitors municipal investment spending every three months and issues warnings if the municipality is falling behind.

Source: DGFIP, note of 30 September 2009 and OECD 2009.

Long-term measures: investments for the future

For the long term, 2010 saw the launch of the "grand loan" for future investments (**distinct** from the recovery plan). The conventions setting the specifications for project selection and investment monitoring procedures were defined in summer 2010, allowing some of the funds to be released rapidly. Calls for projects were expected to be issued by the end of the year. According to the General Commissioner for Investment, they will be issued in successive batches in order to avoid errors, and evaluation mechanisms are to be put in place for tracking performance with the projects year-by-year. Calls have already been issued for projects in health, centres of excellence in low-carbon energy, technological research institutes, and "*équipements d'excellence*" (high-performance scientific equipment).

Obstacles and co-ordination challenges across levels of government – lessons learned?

Co-ordination challenges

The objective gap

As in some other countries, there is an observable dichotomy in France between the municipalities, which have selected investment projects that can be executed quickly (primarily road infrastructure) but are of questionable impact in terms of long-term growth, and the regions, which have taken initiatives with greater thought to the medium- and long-term, especially through the CPER. The projects selected are thus a heterogeneous assortment, for the most part limited in their scope to the municipal level.

The "cohesion" objective was predominant in the design and implementation of the recovery plan, which ensured funding for all regions and territories. This is indeed the case in many OECD member countries, where the cohesion objective also responds to the desire for swift implementation: it is easier to secure parliamentary adoption of plans that do not involve any local discrimination. Competitiveness clusters[13] have not been targeted to play a specific role. The "competitiveness" objective for the recovery has instead been assigned to the programme of investments for the future, where territories will compete for projects and competitiveness clusters are priority targets.

While the experts agree that the various initiatives in support of investment are positive, there is no doubt that they could be better articulated, both among themselves and between levels of government, including the European Union. Thus, the programme of investments for the future is separated from the recovery plan, whereas the two could usefully be made complementary. Moreover, local governments have not to date been involved in selecting priorities for the programme of investments for the future. The CPER have not been activated for the grand loan, although they were for the recovery plan. Nor is there any explicit articulation of investments for the future plan with projects in the context of the Cohesion Policy (co-financed by the European Union), particularly in the framework of the Lisbon strategy.

Certain provisions of the recovery plan have also cast doubt on the coherence of government objectives, particularly when it comes to green growth (the *Grenelle Environnement*, a flagship government programme). Some measures indeed run counter to the Grenelle guidelines, such as financing for motorways, which was frozen at Grenelle (A63 Bordeaux-Spain, A150 Rouen-Le Havre and A355, Strasbourg bypass). By contrast, the recovery plan supports other investment programmes such as rail transport, which are in phase with Grenelle priorities.

The administrative gap

The fragmentation of municipalities – France has more than 36 000 communes, or 40% of all municipalities in the European Union – does little to promote investment at an appropriate scale. Recognising the French communes' essential role in investment (58% of local government investment), management pooling mechanisms are essential. While 85% of the French population is now covered by "inter-communal" structures, these have not replaced the municipal or departmental levels, and their responsibilities are rather vaguely defined. Under the recovery plan, the inter-communal structures showed little interest in the FCTVA refund, and consequently most projects are being conducted at the municipal level and involve renovation works, which do not necessarily earn the best return on investment.

The capacity gap

While the recovery plan expressly targets investment projects that are "shovel-ready" and have passed all administrative hurdles[14] (in the CPER, for example), projects by their very nature take a long time to implement. While funding was committed for two-thirds of the projects in 2009, it was only in 2010 that some of them really got underway, and others will not do so until 2011 or 2012. Thus, their employment impact is bound to be out of phase with the recession. For example, the three big motorway projects and the Seine Nord Canal are programmed from mid-2011. Most of the TGV works will not begin before 2011.[15] Nevertheless, the fact that these prospects exist and have been announced has an impact on the expectations of economic agents, and of firms in particular, and is thus helping to offset the impact of the crisis on employment.

Moreover, the FCTVA refund has posed problems for local governments that made major investments in recent years. A condition of eligibility is that local governments undertake to maintain capital spending at the 2004-07 average. Some local governments have been unwilling to risk such a commitment, fearing that they might not be able to fulfil the targets set by the convention and would therefore receive nothing from the FCTVA in 2010. Strasbourg, for example, preferred not to take the risk for fear that local taxes would have to be raised to finance these investments. The association of rural mayors of France declared that those communes that have made significant investments in recent years were being "penalised" because they could not continue their heady pace of investment (Localtis, 2009).

The fiscal gap

The reforms to territorial arrangements and local finances now underway are casting some uncertainty on recovery plan measures in favour of local governments in terms of their future resources. There are doubts as to their capacities to maintain their investment policy for 2011-12, with the freeze in state subsidies and the elimination in 2010 of the local business tax (*taxe professionelle*) which has historically been a major source of municipal financing (19% of revenues in 2008).[16] The gap between inexorably rising costs and falling revenues and the stagnation or reduction in subsidies from the state (whose own revenues are shrinking) could weigh heavily on many departments and *inter-communalités*. Moreover, persistent uncertainties over local finance reform (the business tax, the "Urban Solidarity Grant", and the future of the FCTVA) could also dampen investment after 2010.

The information gap

At the local level, the information gap has to do not so much with the choice of projects, which are well-defined (for example in the multi-year state-region programmes), but with short-term budget visibility (to 2011), due to uncertainties over local taxation reform. These uncertainties may have distorted certain investment choices and could vitiate the impact of recovery measures. Moreover, as in most countries, there is an *ex post* information deficit linked to the fact that certain expenditures are unrestricted. Thus, the EUR 2 billion allocated to the municipalities under the recovery plan for "green investment" is not specifically allocated to priority sectors. With all the projects carried out in 2009-10, it is at this point difficult to find aggregate data on what has been financed by sector.

Lessons with respect to multi-level governance

The crisis and the implementation of recovery policies have highlighted the importance of instruments to foster co-operation between levels of government, such as the "state-region project contracts". These have played an essential role both by ensuring swift implementation of the plan ("shovel-ready" investment projects awaiting financing) and by identifying projects that are relevant, defined jointly by local and central officials on a geographic rather than a sector basis and with a multi-year horizon (2007-13). The project contracts have shown themselves very useful in an emergency situation for prioritising investment decisions, avoiding precipitous moves and limiting the risk that funds will be wasted. Moreover, they constitute a tool for co-ordination with European Union priorities as they are geared to the European funds' schedule. On this point, the European Commission's decision of November 2008 to speed the implementation of certain European funds has helped reinforce the measures taken at the national level.

Notes

1. *http://publications.oecd.org/acrobatebook/1210012E.PDF.*
2. The recovery plan calls for accelerating "operation campus" at 12 sites, carrying out more than 80 projects included in the state-regions contracts, and developing 15 major research facilities. It calls for renovating more than 100 higher education institutions, 10 research centres and student housing. It also involves the renovation of 163 penitentiaries, renovation and accessibility works in 40 courthouses, accelerated construction of 13 short-term correctional institutes, and the restoration of more than 70 major monuments and over 50 cathedrals.
3. The main measures include the RGPP (General Policy Review), non-replacement of one retiring civil servant in two, and a three-year freeze on public spending. Moreover, a constitutional reform is planned, which would require every local council to establish a five-year deficit reduction plan and commit to a date by which public finances would be in balance.
4. Local government spending represents 11.3% of GDP in France.
5. See list of projects by region: *www.lepoint2.com/sons/pdf/amenagement-territoires.pdf.*
6. In total, the additional funding under the recovery plan (EUR 239 billion over the biennium 2009-10) will speed works to rehabilitate and improve accessibility of rail equipment and carry out the CPER rail operations, for which EUR 225 billion had already been earmarked in 2009.
7. The Strategic Investment Fund is a majority-owned subsidiary of the *Caisse des dépôts*; the state is a minority shareholder.
8. To extend the impact of these measures and allow private investment to take over for public investment, a working group of professionals from the banking and construction sectors has been established to make new proposals.
9. The threshold below which a public contract may be let directly has been raised from EUR 4 000 to EUR 20 000.
10. The 1 000 recovery projects: *www.relance.gouv.fr*; United Nations E-Government Survey 2010, "Stimulus Funds, Transparency, and Public Trust," available at *http://unpan1.un.org/intradoc/groups/public/documents/UN-DPADM/UNPAN038845.pdf.*
11. This total figure includes the EUR 26 billion of the recovery plan as well as loans by OSEO, outlays of the Social Investment Fund, zero-rate loans, the zero-charge mechanism, etc. This sum excludes the other funds released in the context of specific plans such as aid to the banks, the automobile industry, housing or SMEs.
12. *www.relance.gouv.fr.*

13. The *pôles de compétitivité* are clusters individually recognised by the state. The 2005 budget law defined them as "the grouping within the same territory of businesses, higher education institutions and public or private research agencies that work in synergy to carry out economic development projects for innovation". Supported by public subsidies and a special tax regime, they are supposed to make the economy more competitive while countering off-shoring, creating jobs, linking private and public research and boosting development in disadvantaged areas.

14. *www.villesmoyennes.asso.fr/upload/Discours%20Devedjian(1).pdf.*

15. Work on the Brittany-Loire TGV line should begin in 2011.

16. The *taxe professionnelle* was abolished on 1 January 2010 so as not to penalise business investment. As of 2010, businesses are subject to the "territorial economic contribution" (CET), which includes a real estate and a value-added component. Network industries are also liable for a flat-rate tax. The state began collecting these new taxes in 2010 and is paying compensation to the municipalities as a replacement for the *taxe professionnelle*. The proceeds from these taxes are to flow to local governments as of 2011. With this reform, the entire structure of local taxation, and in particular the distribution of taxes between local governments, has been changed.

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Chapter 4

Germany

Macro dimension

Impact of the economic crisis on Germany

Germany's export-reliant economy has been hit hard by the global financial crisis. With the collapse of global demand real GDP fell by more than 6.5%[1] from the beginning of 2008 until the second quarter of 2009 (OECD, 2010). The impact of the global financial crisis varied across regions. In 2008 GDP fell by 7.2% in the western *Länder* and by only 4.5% in the eastern *Länder*. The largest downturns occurred in those *Länder* with a large share in export-oriented manufacturing such as Baden-Württemberg. The crisis in the real economy, which was almost exclusively due to a decline in international trade, was accompanied by a severe banking crisis. German banks which had heavily invested in the US housing market required substantial government intervention.

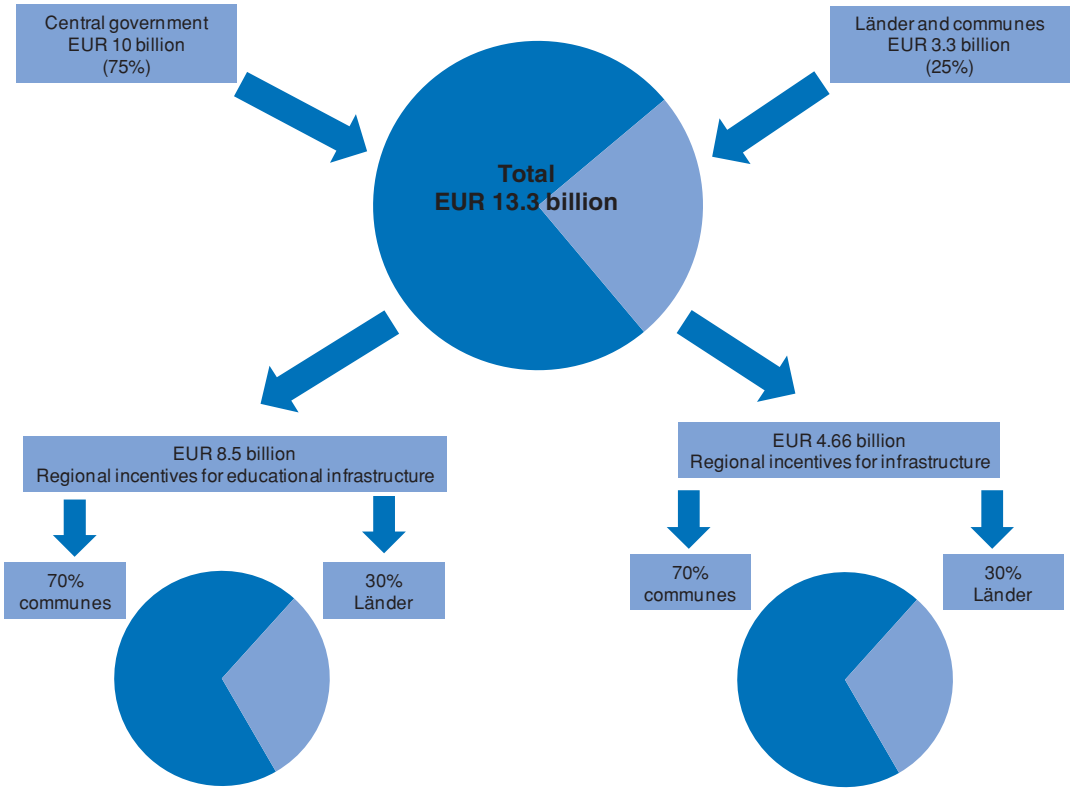
Though the decline in German GDP was above the OECD average, the labour market remained relatively unaffected, primarily because of increased flexibility at the firm level that allowed for a reduction in work hours. The German unemployment rate only rose by half a percentage point to 7.5% in 2008 compared to an average unemployment increase of three percentage points in OECD member countries (OECD, 2010). Economic growth picked up in the second quarter of 2009 due to a combination of fiscal stimulus measures and a rebound in world trade. Pre-2008 GDP levels are expected to be reached again in 2011. Nevertheless, the output gap is still negative and is not expected to be closed until 2015.

Stimulus measures

In addition to the creation of a financial Market Stabilisation Fund of EUR 480 billion aimed at helping out ailing financial institutions, Germany launched a total of four stimulus programmes between October 2008 and November 2009 to stimulate domestic demand and internal growth. Those measures included a fiscal easing package initiated in October 2008, a Stimulus Package I and a Stimulus Package II launched in November 2008 and January 2009 respectively and finally the Law on Speeding Up Growth adopted in December 2009. According to the German Ministry of Finance, the total extent of measures will provide support of EUR 100 billion, totalling 4% of GDP.[2]

According to International Labour Organisation (ILO) calculations, public investments account for approximately 22% of the fiscal measures of both stimulus packages taken together. The remaining 78% are made up by tax and social contribution cuts, labour market programmes and other measures including a cash for clunker scheme. Programmes for green growth, such as investments for improving the energy efficiency of buildings, account for around 15% of all the measures included in both stimulus packages (ILO, 2010).

Figure 4.1. **Distribution of investment funds per level of government**



Source: German Association of Municipalities.

Budget deficits

Prior to the global financial crisis public finances had improved markedly. The budget deficit went down from 3.3% of GDP in 2005 and turned into small surpluses in 2007 and 2008. As a result, gross public debt decreased from 68.0% of GDP in 2005 to 64.9% of GDP in 2007. The cost of stabilising the banking sector and stimulating the economy combined with declining tax revenues led to a deterioration of public finances. The annual deficit amounted to 3.0% of GDP in 2009 and to 3.5% in 2010. Gross public debt increased by 11.5% from 2007 to 2009 reaching a total of EUR 1, 760.5 billion corresponding to 73.4% of GDP. OECD projections expect gross public debt to reach 79.1% of GDP in 2010 and 83% of GDP in 2011 (OECD, 2010).

Gross public debt of the *Länder* increased by 9.0% in 2009 reaching EUR 526.7 billion while central government debt increased by only 6.9% reaching a total of EUR 1 053.8 billion. At the local level, debt increased by 4.5% in 2009 totalling EUR 113.8 billion.

Exit strategy

In the light of this considerable increase in budget deficit, the policy challenge is to bring public finances back to a sustainable path. Fiscal consolidation will be complicated by the fact that some stimulus measures are not time-limited. As part of a larger reform of the federal structure, the German Government adopted a new fiscal rule in March 2009

that will limit the cyclically adjusted budget deficit of the federal government to a maximum of 0.35% of GDP and require balanced cyclically adjusted budgets for the *Länder*. It will become binding for the central government in 2016 and for the *Länder* in 2020. A longer transitional period has been agreed for the *Länder* since some are experiencing serious consolidation problems.[3] No borrowing limits have been specified for municipalities and social security funds (OECD, 2010). To comply with the new fiscal rule, the German Government has announced a reduction of the structural deficit at the federal level by about 0.3% of GDP each year until 2016.

In addition to the new fiscal rule, the German Government created a Stability Council that consists of the Minister of Finance, the Minister of Economy and the finance ministers of all the *Länder.* To avoid future budgetary crises, the Stability Council will regularly monitor the budgets of the federal government and the governments of the *Länder* and function as an early warning system. If a budget risks falling into distress, the responsible government develops a consolidation plan with the Stability Council. The council will then monitor the implementation of the consolidation plan on a semi-annual basis (OECD, 2010).

Design of the public investment scheme

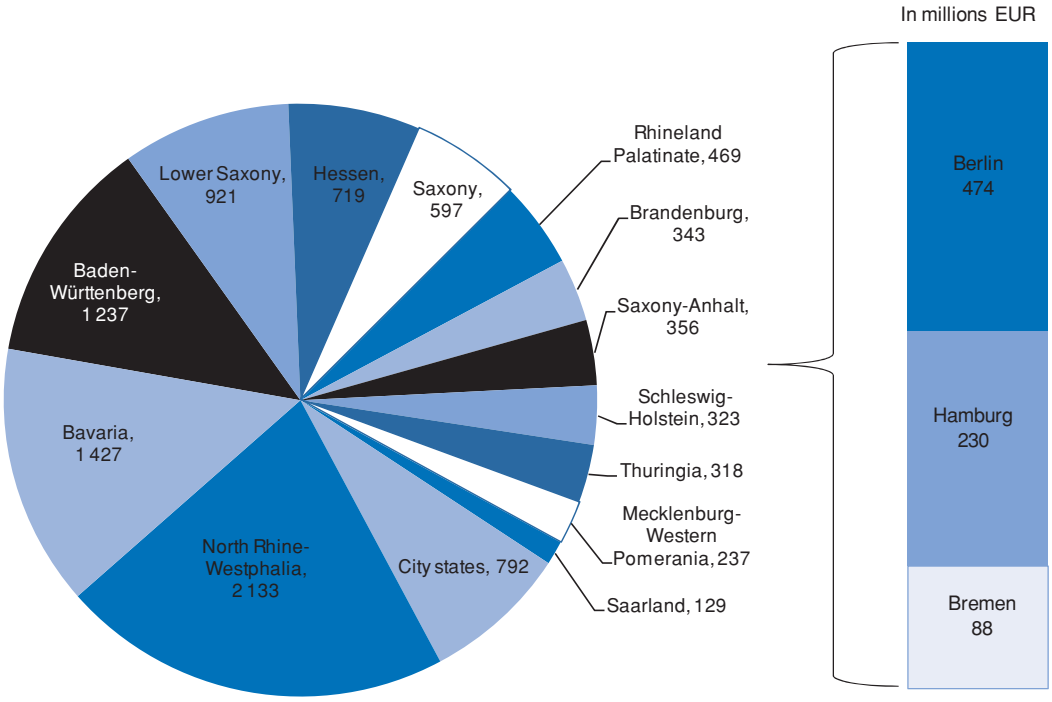
Key German public investment priorities

As mentioned, public investments account for approximately 22% of the measures included in both stimulus packages. The first stimulus package allocates EUR 2 billion for infrastructure investments, whereas the second stimulus package foresees a total of EUR 17.3 billion for investments in educational facilities, hospitals and infrastructure. Out of these EUR 17.3 billion, EUR 4 billion are intended for federal investments, mainly investments in the modernisation of the *Bundesautobahnen*. The remaining EUR 10 billion are part of a sub-national investment scheme that accrues to the *Länder* as well as to municipalities. *Länder* and municipalities are involved in the co-financing of the sub-national investment scheme of at least EUR 3.3 billion, which results in total investments of at least EUR 13.3 billion.

Involvement of sub-national governments

The sub-national investment scheme accounts for around 26% of the funds provided by the Stimulus Package II. As mentioned earlier, EUR 10 billion are being provided by the central government while *Länder* governments and municipalities contribute EUR 3.3 billion to this scheme. 65% of these funds (EUR 8.65 billion) are planned for investments in educational facilities. Infrastructure investments account for EUR 4.7 billion (35 % of the total funds). The funds are distributed among the 16 *Länder* as shown in Figure 4.2. The distribution formula is a combination of several factors, including the population sizes of the *Länder*. The *Länder* governments are required to invest a minimum of 70% of these funds in the municipal infrastructure.

Figure 4.2. **Distribution of investment funding per *Land (Future Investment Act)***



*Draft bill dated 27/01/2009.

Source: German Association of Towns and Municipalities.

Only certain types of projects are eligible for funding within the two main areas (education and infrastructure). In the educational domain these include investments in research and development, investments in day-care facilities for children and finally investments in schools, universities and municipal training facilities with a particular focus on energy-efficient renovation, thereby contributing to long-term environmental sustainability. In the area of infrastructure, investments in hospitals, information technology and in urban and rural development qualify for funding. Exempt from funding are investments in waste water systems and in public transport. The Stimulus Package II includes an additionality requirement and does not permit double funding. Concretely that means that projects whose funding is already secured by the 2009 budget are not eligible for funding by the stimulus package. Exempt from funding are also those projects that receive financial support from other federal programmes.[4] Only investments that are additional to the ones already scheduled in the 2009 budget and that do not receive financial support from other sources qualify for funding.

Incentives to promote public-private co-operation

Within the sub-national investment scheme, there are no specific regulations on public-private partnerships (PPP). Principally, federal grants from the *Zukunftsinvestitionsgesetz* can also be obtained by a PPP, as long as the promotion of the public-private partnership is in line with the conditions of the investment scheme.

Transparency

Information on the coverage and design of the stimulus packages is available on the website of the German Ministry of Finance as well as on the website of the German Ministry of Economics and Technology. More in-depth information on the implementation of the sub-national investment scheme can be obtained from the individual websites of the *Länder,* who are fully responsible for the implementation of the sub-national investment scheme within their jurisdiction. The German Association of Municipalities (*Deutscher Städte- und Gemeindebund*) as well as the German Association of Cities (*Deutscher Städtetag*) provide additional details on the local perspective of the sub-national investment scheme. There is no common portal specifically on the stimulus packages that brings together the insights available on each of these individual websites, which is a result of the decentralised implementation of the investment scheme. Since the implementation differs greatly amoung the *Länder*, the provision of information on amount of funds allocated to specific projects and the share of funds already paid out is very challenging.

Implementation of the public investment scheme

Implementation of investment scheme

The *Länder* are responsible for the implementation of the sub-national investment scheme. Aside from the above-mentioned requirements, each *Land* is free to decide about the details of fund allocation. Given this regional autonomy, a multitude of different allocation procedures has emerged (see Box 4.1 for the example of Nordrhein-Westfalen).

According to the Federal Ministry of Finance, EUR 15.1 billion had already been allocated to specific projects as of mid-November 2010. 97.1 % of the EUR 10 billion of federal investment grants have already been allocated. The sub-national investment scheme seems to have had a stimulating impact on the economy as municipal construction increased by 13.5% in the third quarter of 2009.[12]

Box 4.1. **Implementing the investment package: the case of Nordrhein-Westfalen**

The regional government of Nordrhein-Westfalen was among the first to reach an agreement with its municipalities on the allocation of funds. The "Pact for the Future of Municipalities" adopted on 30 January 2009 allows for 83.68% of the funds to be allocated to municipalities, thereby surpassing the federal minimum requirement of 70%. Given that it is Germany's most populous *Land*, the funds assigned to Nordrhein-Westfalen amount to EUR 2.844 billion, out of which EUR 2.38 billion will accrue to its municipalities. The remaining EUR 464 million will be invested by the government of the *Land* itself, mainly in university infrastructure and research institutions.[1]

The government of Nordrhein-Westfalen and the municipalities agreed on two different allocation mechanisms. In the area of education, funds accruing to the municipalities will be allocated according to school enrolment numbers. Half of the funds in the area of infrastructure will be implemented according to population and area size whereas the other half will be distributed according to a special mechanism privileging financially weak communities.[2] Municipalities are not required to file an application for every single project. They only submit one application for projects planned in a specific quarter and receive funds quarterly. To allow for more flexibility, the Association of Municipalities in Nordrhein-Westfalen set up a sharing network where investment allocations can be exchanged between municipalities. This way the overall ratio between educational and infrastructure investments will be guaranteed.

Box 4.1. **Implementing the investment package: the case of Nordrhein-Westfalen** *(cont'd)*

A special fund has been set up that allows the municipalities and the *Land* to amortise their financial contribution to the sub-national investment scheme over a period of ten years starting in 2012. The *Land* of Nordrhein-Westfalen will provide 87.5% financial contributions. Only 12.5% of the contributions will fall upon the municipalities.

Nordrhein-Westfalen is a good example of a decentralised approach to the implementation of the sub-national investment scheme.

1. Bericht über die Umsetzung des Zukunftsinvestitionsgesetzes in Nordrhein-Westfalen, *www.im.nrw.de/bue/doks/konjunkturpaket/landesbericht_bmf_090625.pdf*, 26 May 2009.

2. Arbeitsgemeinschaft der kommunalen Spitzenverbände NRW, *Presseerklärung*, *www.aba-fachverband.org/fileadmin/user_upload/user_upload_2009/politik_zeitgeschehen/NRW%20Konjunkturpaket%20II%2030.1.2009.pdf*, 30 January 2009.

Public actors in charge of implementing/monitoring at central and sub-central level

The sub-national investment scheme of the Stimulus Package II has been jointly agreed upon by the federal Finance Minister and the finance ministers of the *Länder*. The *Länder* governments in turn have decided together with representatives of municipalities on the concrete implementation of the investment scheme. Some *Länder* have considered creating special bodies in charge of allocating funds to municipalities. Given the investments scheme's focus on municipal infrastructure, the main task of administering investments fell to local authorities. At the *Länder* level, ministries of education among others played an important role in administering investments.

The federal Ministry of Finance requires the *Länder* to report on all the projects funded by the sub-national investment scheme. Five months after a project is finished, the *Länder* have to report back to the federal Ministry of Finance. In particular, they need to prove that the use of funds satisfied the additionality requirement. If needed, the Ministry of Finance can require additional documentation. Municipalities also need to report back to the *Länder* governments, but different reporting and monitoring arrangements exist in all 16 *Länder*.

Main obstacles and co-ordination challenges across levels of government – lessons learned?

Obstacles and co-ordination challenges in the design and implementation of the sub-national investment scheme

The design of the sub-national investment scheme reflects a strong political commitment to expand and improve the educational infrastructure and the long-term environmental sustainability of the economy. While the sub-national investment scheme has generally been perceived as positive by municipal authorities, there has been some concern with regard to the additionality requirement and the exclusion of waste water systems and public transport from funding, two areas which also require substantial investments.[5] The reasoning behind the additionality requirement has been to avoid

replacing municipal funds by federal funds. Investments are required to be additional to the already scheduled ones in order to provide the needed boost to the economy. The focus on additional investments is sensible in terms of economic stabilisation policy but it produces implementation lags. Additional investments take time to plan and implement while the implementation of shovel-ready projects is almost immediate. The additionality requirement also requires substantial reporting and documentation. Municipalities have expressed some concern about the practicality of the additionality requirement.[6] Meanwhile, the additionality requirement has been modified and simplified by Parliament in order to meet demands of *Länder* governments.

While the Stimulus Package II endows municipalities with substantial additional funds, it also requires additional expenditures. In particular, additional unemployment benefits will place a strain on municipal budgets. At the same, tax cuts and cuts in social contributions included in all four stimulus packages in addition to the unfavourable economic climate will lead to reduced municipal revenues in the upcoming years. Reduced revenues and additional expenditures will restrict the scope of manoeuvre even as municipalities receive substantial funds. A more general challenge is the growing share of social security expenditure. Social security expenditure has increased five-fold since the 1970's and now accounts for almost one-fourth of total spending. The share of expenditure on investments on the other hand has decreased by two-thirds (Deutscher Städtetag, 2009). Since social security expenditure is generally regulated by federal guidelines, this trend has restricted the fiscal autonomy of municipalities.

Overall, the sub-national investment scheme includes very little federal guidelines and transfers the responsibility of implementation to the *Länder* and municipalities. This has led to a multitude of different allocation mechanisms. While this great variety of allocation mechanisms can be thought of as an obstacle to a uniform implementation of the investment scheme, it also allows the *Länder* governments to respond to regional specificities. Also, the great deal of leeway for the *Länder* as well as the minimal administrative requirements set by the federal government were targeted at rapidly implementing the investment scheme. The speed at which all *Länder* and municipalities allocated the means to specific investment projects – within about 12 months 90 % of the federal grants were already allocated – impressively shows that this goal has been achieved.

More problematic than the lack of a uniform allocation mechanism seems to be the prohibition of direct financial transfers from the central to the sub-national governments which resulted as a consequence of the 2006 federalism reform. In Germany, federal laws that produce substantial financial obligations for sub-national governments require the approval of the *Bundesrat* which is the chamber of the German Parliament representing *Länder* governments. The 2006 federalism reform aimed at reducing the share of approval laws from 60 to 30% to reduce political blockage (Bundesrat, n.d.). In practice, that implied a division of policy responsibilities, a reduction of common projects especially in the area of education and a prohibition of direct financial transfers.

Lessons learned

While it is too early for a comprehensive assessment of the adaptability of the German multi-level governance structure to a situation of economic crisis that demands urgency as well as farsightedness, it is clear that the recent experience has highlighted a number of challenges. With the reduction of approval laws the federalism reform has certainly helped to reduce reform blockage since the *Länder* dominated *Bundesrat* is no

longer required to agree to the majority of federal laws. On the other hand, the division of responsibilities might have complicated concerted action of all levels of government in a situation of economic crisis.

The crisis also reveals a more general challenge: the increase of social security expenditure at the expense of a decline in investment expenditure, the latter being regulated by federal guidelines. This fiscal co-ordination challenge will become particularly relevant in the context a future renegotiation of the allocation of tax revenues among the levels of governments. Currently the main source of revenue for municipalities is the trade tax. The current development of municipal finances has shown that the municipal financial system has shortcomings. The implementation of the stimulus packages has temporarily eased financial constraints, but several German municipalities still have budgetary problems, which restrict their freedom of action. Hence, the federal government has decided to appoint a reform commission (*Gemeindefinanzkommission*). Its main tasks are to elaborate proposals for a new order of municipal finances to examine how municipalities can be more involved in the legislative process as well as to work out possibilities to cut expenditures (e.g. by more flexible standards). The commission appointed three working groups, of which two have completed their assignments. The commission intends to present results as soon as the working group for municipal revenues has reached an agreement.

Eventually successful implementation of investment schemes will depend on the capacity at the sub-national level in terms of human knowledge and infrastructure. Since the implementation of the sub-national investment scheme varies considerably between the *Länder*, best practices for successful multi-level governance can only be distilled in the future after the investment scheme has been phased out. The case of Nordrhein-Westfalen might, for example, provide valuable insights for successful co-operation between municipalities and the *Länder* governments and between municipalities themselves.

Notes

1. Modest declines in GDP in the second and third quarters of 2008 were followed by much steeper contractions of 2.4% in the fourth quarter of 2008 and 2.5% in the first quarter of 2009.
2. This includes the re-introduction of the commuter mileage allowance.
3. Particularly Bremen and the Saarland.
4. The only exceptions are programmes financed through loans from the *Kreditanstalt für Wiederaufbau*.
5. Antwort der Bunderegierung auf die Kleine Anfrage der Abgeordneten Katrin Kunert, Ulla Lötzer, Dr. Gesine Lötzsch, Dr. Barbara Höll un der Fraktion DIE LINKE, *http://dip21.bundestag.de/dip21/btd/17/012/1701255.pdf, 12 March 2010*

6. Deutscher Städte- und Gemeindebund, *Zukunftsinvestitionsgesetz – BV plädiert für Änderung des Kriteriums Zusätzlichkeit*, *www.dstgb.de/homepage/artikel/schwerpunkte/gemeindefinanzen/finanzmarktkrise_und_konjunkturpaket_ii/zum_schwerpunkt/konjunkturpaket_ii_von_unten/zukunftsinvestitionsgesetz_bv_plaediert_fuer_aenderung_des_kriteriums_zusaetzlichkeit/index.html.*

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Chapter 5

Korea

Macro dimension

Impact of the economic crisis on Korea

As an export-oriented country with an open capital account, Korea has been severely hit by the global financial crisis. The decline in exports was particularly sharp given Korea's concentration on medium and high-technology products, which are very cyclically sensitive. Korea's GDP decreased by 17% (at an annual rate) in the fourth quarter of 2008, more than double the average drop of GDP in OECD member countries (OECD, 2010a: 22). However, it should be mentioned that the Korean economy was already slowing prior to the intensification of the global financial crisis in September 2008, reflecting the US recession that had begun in December 2007, rising oil prices and the impact of tighter monetary policy.

The drastic economic downturn was accompanied by large outflows of foreign capital. As a consequence, Korean firms turned toward the domestic banking sector. However, domestic banks themselves faced financial troubles as they had accumulated large external debts in the years prior to the crisis and found it difficult to roll over these loans given the global liquidity crunch. These adverse developments put downward pressure on the Korean won. By the first quarter of 2009, the won was 31% below its level a year earlier, the second largest drop in the OECD after Iceland (OECD, 2010a: 22). The rapid decline of the won in 2008 brought back memories of the 1997 crisis, although the underlying causes of the two crises were very different. While the 1997 crisis was triggered by the collapse of the internal financial market, the 2008 crisis was mainly caused by external factors.

Yet, the depreciation of the won also helped the Korean economy rebound. Combined with high growth rates in China, which receives almost one-third of Korean exports, it gave rise to a strong export-led recovery. Korea went up from being the world's 12th largest exporter in 2008 to the 9th largest in 2009 (OECD, 2010a: 11). By the second quarter of 2009, GDP growth in Korea already averaged 3% (ILO, 2010). Despite positive growth rates, the labour market situation had not improved. After reaching a peak of 3.9% in May 2009, the unemployment rate decreased slightly, only to jump up again to 4.8% in January 2010 (ILO, 2010).

Stimulus measures

Export-led recovery was helped by a timely and comprehensive policy response. To stabilise financial markets and alleviate the credit crunch, Korea's central bank provided KRW 28 trillion of liquidity, about 2.7% of GDP. It also lowered its policy rate from 5.25% in 2008 to a record low of 2% by February 2009. Additional liquidity was provided by a KRW 10 trillion Market Stabilisation Fund that was financed by the Korean Government and other public organisations (OECD, 2010a: 72-75).

Besides financial market stabilisation measures, the Korean Government also implemented measures to stimulate the real economy. Over the period 2008-10, stimulus measures amounted to 6.1% of 2008 GDP (around KRW 62 trillion), which is the largest package among the 26 OECD member countries adopting explicit crisis-driven stimulus programmes. Additional expenditure was included in a September 2008 supplementary budget and in the 2009 budget, along with temporary tax cuts. Another supplementary budget followed in April 2009, while personal and corporate income tax rates were permanently cut in 2009-10.

The stimulus is almost evenly divided between **additional expenditure** (3.2% of GDP) and **tax cuts** (2.8%):

- On the **expenditure** side, the first spending category was public investment (1.2% of GDP and 36.1% of the total stimulus package, i.e. KRW 10.1 trillion out of KRW 28.0 trillion). Public investment targeted mostly transport and energy. Public investment has been driven in part by the "Green New Deal Policy" announced in January 2009, which included major infrastructure projects such as the Four Major Rivers Restoration Project and railroad construction that boosted short-term public employment. A second major spending category was transfers to businesses (1% of GDP), particularly SMEs. The remaining expenditures was divided into transfers to households (0.7% of GDP), transfers to sub-national governments (0.3% of GDP) and miscellaneous other measures (0.1% of GDP).
- On the **tax** side, about half of the cuts were targeted on households (1.4% of GDP). Most of the tax reductions were temporary measures for low-income households and cuts in housing-related taxes. Tax cuts for businesses (1% of GDP) were aimed at boosting corporate investment and R&D. Finally, consumption taxes were lowered, including those on cars, thus helping to boost car sales in Korea by 20% in 2009. In addition to these temporary measures, there were permanent cuts in income tax rates.[1]
- Generally, the policy responses have been appraised as very successful in stabilising financial markets and stimulating the real economy. The timeliness and efficiency in responding to the crisis was partly due to the experience gained in the 1997 crisis. In the wake of the Asian financial crisis, Korea had created a number of institutions to guarantee the transparency and stability of financial markets. These institutions, most notably the Financial Supervisory Commission and the Bank of Korea, whose independence had been enhanced, proved to be very helpful in dealing with the current financial turbulences. The fiscal response was also particularly important in sustaining employment. It is estimated that the unemployment rate during 2009 would have been 4.3% – rather than the 3.6% recorded – without the additional public jobs. Employment gains boosted wage income and helped to sustain private consumption growth, which was the highest in the OECD area during 2009.

Budget deficits

As a result of falling revenues and additional expenditure, the consolidated central government budget (excluding the social security surplus) widened from 3.3% in 2008 to 4.1% in 2009. With the recovery on track, government spending has been reduced in 2010, and the government plans to bring fiscal deficit to close to zero by 2013 (OECD, 2010).

Korea's gross government debt amounted to 32% of GDP in 2008 and increased slightly to 35% in 2009. While well below the OECD average of 79% in 2009, it represented a significant increase compared to Korean debt-to-GDP ratio before the Asian financial crisis in 1996, which amounted to 10% (OECD, 2010a: 53).

Table 5.1.Fiscal stimulus in Korea

Announced or implemented over the period 2008-10 as a share of 2008 GDP

Spending measures	% of 2008 GDP	Tax cuts	% of 2008 GDP
Total[1]	3.2	Total	2.8
Public investment	1.2	For individuals	1.4
Transport	0.4	Targeted on low-income groups	0.6
Energy	0.2	Increased personal tax allowance	0.1
Other[2]	0.6	Oil tax rebate	0.5
		Reductions in housing-related taxes	0.4
		Personal income tax cut	0.3
Transfers to households	0.7	For businesses	1.1
Pensions	0.3	Tax relief associated with new spending	0.4
Unemployment benefits	0.2	R&D	0.1
Lengthening benefit duration	0.1	Investment	0.3
Loosening eligibility criteria	0.2	Corporate income tax cut	0.7
Other income-related transfers	0.1		
Transfers to businesses	1.0	On consumption	0.2
Small and medium-sized enterprises	0.4	Cuts in general consumption taxes	0.1
For public financial institutions	0.3	Cuts in car-related taxes	0.1
To job-creating companies	0.2		
Construction and transport sectors	0.1		
Other	0.1	Other	0.2
Transfers to sub-national governments	0.3		

1. The government increased spending in FY2008 through a supplementary budget of KRW 4.6 trillion passed in September 2008. For FY2009, spending was boosted by KRW 11.4 trillion in December 2008 and by a supplementary budget of KRW 17.2 trillion that was passed in April 2009.

2. Includes 0.1% of GDP each for agriculture, education, public services, environmental protection, defence, and housing and health.

Source: OECD (2010) *OECD Economic Surveys: Korea 2010*, OECD Publishing, Paris, doi: 10.1787/eco_surveys-kor-2010-en.

Exit strategy

A large number of tax cuts and benefits were to be withdrawn in 2010. These measures helped Korea to limit its current gross government debt of 35% of GDP to less than 40% in 2010, well below the OECD average of 96%. Given Korea's aging population and the strain this will place on public finances in the upcoming years, fiscal consolidation has become a priority for the Korean Government. The government scaled back fiscal stimulus in the 2010 budget by cutting spending by 4.2% relative to 2009 (including the supplementary budget). To reduce spending, the government eliminated some of the projects funded by the stimulus packages that appeared to be less effective. The largest cut by spending category in 2010 was a 30.8% fall in industry, SMEs and energy where much of the fiscal stimulus had been concentrated. Significant spending reductions are also planned for the environment (5.3%), general public administration (4.1%) and education (3.6%). This will be partially offset by a 7.1% rise in R&D spending, in line with Korea's 2008 mid-term plan to boost public R&D by 50% between 2008 and 2012. The investment will be concentrated in basic science, new growth engines and green technologies, i.e. key levers for long-term growth.

Design of the public investment scheme

Key Korean public investment priorities

Public investments accounted for approximately 36% of the stimulus measures introduced between 2008 and 2010. Around 0.4% of GDP was targeted at transport networks. Investments in energy infrastructure received support amounting to 0.2% of GDP and the remaining 0.6% was distributed across projects in the areas of agriculture, education, public services, environmental protection, housing, health and defence (around 0.1% for each) (OECD, 2010a: 51; 2010b). Funding focused on metropolitan regions and cross-border regions (OECD, 2010b).

These investments were partly driven by the "Green New Deal Policy" announced in January 2009 as a response to the economic downturn in the short term by creating jobs while also strengthening the foundations for green growth in the medium to long term. The "Green New Deal Policy" represented a consolidation of previous plans with increased expenditures woven in to counter the crisis. The "Green New Deal Policy" was later absorbed and expanded by a Five-Year Green Growth Plan, which was released in July 2009 with a total funding of KRW 107.4 trillion (USD 89.5 billion). The plan calls for spending 2% of GDP each year over the 2009-13 period across 600 green growth projects, to be completely financed by the central government (except for KRW 8.5 trillion by two public enterprises). Two of the ten spending categories, which are mainly focused on public construction, account for more than half of total expenditures: "Strengthening the capacity to adapt to climate change" and "Greening the land and water and building the green transport infrastructure" (OECD, 2010a: 142). Projects foreseen in the first category include the expansion of Korea's high-speed train system as part of the government's plan to boost the share of passenger transport by rail from 18% in 2009 to 26% in 2020. The second category includes the "Four Major Rivers Restoration Project", which promotes the construction of special dams and the heightening of agricultural reservoir banks.

The October 2009 mid-term fiscal plan incorporated the expenditures contained in the Five-Year Green Growth Plan announced in July. Nevertheless, the total amount of spending for the years 2011-12 did not increase compared to the 2008 mid-term fiscal plan – possibly because outlays in some non-green growth categories may have been cut and/or some previously planned expenditures may have been re-categorised as green growth.

Involvement of sub-national governments

Around 75.2% of the investment package is targeted at sub-national governments (KRW 7.6 trillion out of KRW 10.1 trillion).

Co-funding (matching) of the investments was based on the fiscal capacities of sub-national governments (OECD, 2010b). The conditions for matching grants have been relaxed. For example, matching rates required from sub-national governments were lowered and the evaluation of co-funding capabilities was loosened.

In addition, sub-national governments received transfers from the central government amounting to 0.3% of GDP.

Table 5.2.The Five-Year Plan for Green Growth (2009-13)

Trillions KRW

	Total	2009	2010	2011	2012	2013
Total	107.4	17.4	24.2	25.7	20.6	19.4
Central government budget	98.9	17.4	20.5	21.9	19.6	19.4
Public enterprises' investment	8.5	--	3.7	3.8	1.0	--
Memorandum item: total green technology R&D investment in all categories	(13.0)	(1.9)	(2.2)	(2.5)	(2.8)	(3.5)
A. Adapting to climate change and enhancing energy independence	57.5	8.5	15.5	16.0	9.8	7.7
1. Effective mitigation of greenhouse gas emissions	5.4	1.0	0.9	1.0	1.1	1.3
2. Reduction of the use of fossil fuels and the enhancement of energy independence	15.4	2.8	3.8	2.9	3.0	2.8
3. Strengthening the capacity to adapt to climate change	36.7	4.7	10.9	12.0	5.6	3.6
(Four Major Rivers Restoration Project)	*(15.4)*	*(0.8)*	*(6.4)*	*(7.1)*	*(1.1)*	*(--)*
B. Securing new growth engines	23.5	3.9	4.1	4.7	5.3	5.6
4. Development of green technologies	7.6	1.5	1.4	1.5	1.5	1.6
5. The "greening" of existing industries and promotion of green industries	4.5	0.7	0.9	0.9	1.0	1.0
6. Advancement of industrial structure to increase services	9.7	1.4	1.5	2.0	2.4	2.5
7. Engineering a structural basis for the green economy	1.8	0.3	0.2	0.3	0.4	0.5
C. Improving living standards and enhancing national status	26.4	5.0	4.6	5.1	5.6	6.1
8. Greening the land and water and building the green transport infrastructure	23.9	4.6	4.2	4.6	5.0	5.5
9. Bringing the green revolution to daily lives	1.8	0.3	0.3	0.3	0.4	0.4
10. Becoming a role model for the international community as a green growth leader	0.7	0.1	0.1	0.1	0.1	0.1

1. Actual budgets for 2009-10 and projections for 2011-13.

Source: OECD (2010), *OECD Economic Surveys: Korea 2010*, OECD Publishing, Paris, doi: 10.1787/eco_surveys-kor-2010-en.

Incentives to promote public-private co-operation

Public procurement procedures were simplified. In particular, procedures for approval and disbursements were simplified. The length of the procurement period was shortened from 79-90 days to 20-38 days. There was also an increase in the liquidities offered to the private sector and private investors had the possibility to receive loans at the interest rate of government bonds. The evaluation of the traffic and environmental impact of projects was also accelerated.

Since public-private partnerships (PPPs) were first introduced in Korea by the Promotion of Private Capital into Social Overhead Capital Investment Act in 1994 and the Act on Private Participation in Infrastructure (PPI Act) in 1998 after the 1997 financial crisis, they have been used in projects managed both by the central and local governments (Table 5.3). Major projects conducted through a PPP include, for example, the Seoul Beltway Northern Section, the Incheon International Express Highway and the Busan New Port Phase 1. With the recent decrease in private demand and the sharp increase in the public sector (Figure 5.1), a first round of measures to revitalise PPPs was taken in February 2009 to ease the credit crunch (e.g. the introduction of the Korean Development Bank's Special Loan Programme and the Infrastructure Credit Guarantee Fund), followed by a second round of measures in August 2009 (e.g. strengthened tax incentives and the development of a new risk-sharing scheme in October).

Table 5.3.PPPs and financial subsidies by level of government and type of project

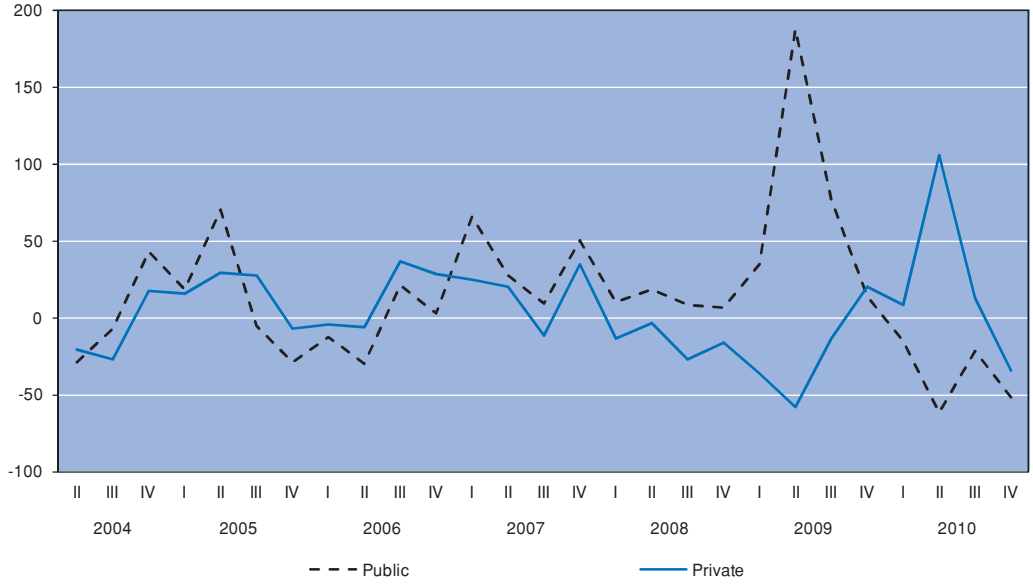
Billions KRW, %

Type		Number of projects	Total project cost (amount)	Total private investment project cost (amount)	Financial subsidy for construction	
					Amount	%
Central government managed projects	Road	34	24 718	19 761	4 957	20
	Railways	11	10 134	6 146	3 988	39
	Seaports	17	4 810	3 720	1 090	23
	Logistics	5	860	849	11	1
	Airports	7	602	602	0	0
	Environment	9	1 369	374	995	73
	Subtotal	83	42 492	31 452	11 040	26
Local government managed projects	Roads	19	2 172	1 783	389	18
	Parking lots	24	205	203	2	1
	Environment	50	1 771	743	1 028	58
	Other	9	804	752	53	7
	Subtotal	102	4 953	3 480	1 472	30

Source: Korea Development Institute (2010), "Global Financial Crisis and Fiscal Implications of PPPs in Korea", Powerpoint presentation, 12 April, *www.oecd.org/dataoecd/40/39/45038031.pdf*.

Figure 5.1. **Number of construction orders received by type of order**

%/year-on-year % change



Source: Korea Development Institute (2010), "Global Financial Crisis and Fiscal Implications of PPPs in Korea", Powerpoint presentation, 12 April, *www.oecd.org/dataoecd/40/39/45038031.pdf*.

Transparency

So far, data on local public finances were made available only to the citizens of each local government, but starting from 2011 the Ministry of Public Administration and Security (MOPAS) is planning to publish a comprehensive set of data every October as part of a strategy to consolidate local public finances and encourage citizen participation.

Implementation of the public investment scheme

Implementation of investment scheme

The plan has focused on the reinforcement of existing investments and on shovel ready investments (Table 5.4), and the total investment funding had been allocated by the end of 2009 (OECD, 2010b). The extensive list of shovel-ready projects includes most notably the Four Major Rivers Restoration project. The government views the project as a solution to rising unemployment, while concerns have been raised that the link between the spending on river management and the development of new sources of growth has yet to be demonstrated other than by creating a limited number of precarious jobs.

Table 5.4.Type of investment selected in priority

		Description
	New types of investments projects	
x	Reinforcement of existing investments	Front loading of fast train construction, urban trains construction
x	Shovel ready investments (e.g. investment projects ready to launch)	Construction of roads, redevelopment of rivers

Source: Response to OECD (2010), "OECD Questionnaire Response, Making the Most of Public Investment Recovery Strategies, Multi-Level Governance Lessons from the Crisis", OECD, Paris.

If funds were not spent during 2009, they were withdrawn by the end of the year. Local governments spent 5.8 percentage points more of their budget than the initial target (KRW 96.3 trillion vs. the target of KRW 91 trillion) in the first half of 2010. The Ministry of Public Administration and Security (MOPAS) carried out a mid-term comparative evaluation of local finance execution between January and March 2010, and announced it would reward the best performing local governments with a total special shared tax of KRW 10 billion (KRW 1 billion each for Gwangju Metropolitan City and the province of Gyeongsangbuk-do, the top spenders).

Public actors in charge of implementing/monitoring at central and sub-central level

The national government, in particular the Ministry of Finance, decided upon investment priorities. The Emergency Economic Response meetings chaired by the President of the Republic started in January 2009 and take place almost every week in the Blue House (the President's office). A series of Crisis Management Response meetings was also inaugurated in August 2008, chaired by the Minister of Finance and aimed at promoting consultation among ministries on the policy response to the crisis. It takes place every week in the Government Complex in Gwacheon. The sub-national governments were responsible for implementing the investment measures.

Main obstacles and co-ordination challenges across levels of government – lessons learned?

Co-ordination challenges across levels of government

Whether the crisis has raised Korea's awareness of long-term economic and fiscal priorities remains to be seen. Speedy response to the crisis has prompted the simplification of *ex ante* evaluation procedures (OECD, 2010b). The central government

encouraged local governments to accelerate spending and to issue local bonds during the first half of 2010. However, local debts soared dramatically with the rapid increase of expenditures and the fall in revenues. In particular, social welfare expenditures increased from 9.5% of local government budgets in 2002 to 19% in 2010. The central government has recently asked local governments to reduce their expenditures.

The recovery package was run through a sizeable budget deficit, both for the central government – the main funding authority – and for local governments, which registered a significant loss of revenue and had to rely on subsidies from the central government. Local public finance was severely hit by the crisis.[2] The total balance of local government budgets plunged from a surplus of KRW 20.2 trillion in 2008 to a deficit of KRW 7.1 trillion in 2009. The average fiscal autonomy of local governments decreased from 59.4% in 2000 to 53.6% in 2009 and 52.2% in 2010 (which represents a fall by 17.1% from 1997, the first year when local public finance statistics were available). The capital region registers relatively good fiscal autonomy (over 90% in Seoul Special City, 75.9% in Gyeonggi Province, 74.2% in Incheon Metropolitan City in 2009) compared with other regions (58.3% in Busan Metropolitan City and only between 20-30% in most other provinces). More than half of basic local governments (55.7%) were unable to cover their staff costs with their own revenues in 2010. On 12 July 2010, the municipality of Seongnam (which is located in Gyeonggi Province and had one of the highest levels of fiscal autonomy in the country with 67.4% in 2010) announced that it was unable to repay its debts. Following this announcement, the central government announced the introduction of an "*ex ante* alerting system for local finance crisis" starting from 2011, which will assess local governments in three categories ("normal", "caution needed" and "serious") and will limit the capacity of the local governments in the third category to issue bonds and to launch new large-scale projects.

Regions and municipalities were not involved in the selection of investment priorities (OECD, 2010b). The series of Crisis Management Response meetings started in August 2008 (see above) but it was only on 28 April 2010 that a local government participated for the first time. During the meeting, the province of Chungcheongnam-do reported on its strategy to attract investment and foster regional development and proposed that the central government support the relocation of firms from the capital region to other regions. On the latter matter, the central government answered that no additional support would be provided in 2010 as the allocation of the 2010 budget across regions had been finalised, but it would consider increasing transfers to regions in 2011 to better reflect regional needs. On 3 August 2010, the Ministry of Strategy and Finance (MOSF) held a consultation meeting on local finance with local governments and presented its "10-10 Strategy" to reduce 10% of spending on the least performing projects and apply ten principles to increase the efficiency of spending (including strengthened *ex ante* cost-benefit analysis, strategic financial management, etc.). The Korean Chamber of Commerce (KORCHAM) has conducted a survey in 71 local assemblies and has produced a report that lays out 40 priorities in seven fields, almost 60% of which concern deregulation and improvement of local infrastructure (roads, ports, etc.). It has announced that it will send the report to the Ministry of Strategy and Finance (MOSF); the Ministry of Knowledge and Economy (MKE); the Ministry of Land, Transport and Maritime Affairs (MLTM), etc.

Horizontal co-operation between municipalities was not specifically encouraged by the national government for the implementation of investment measures (OECD, 2010b). However, cross-jurisdictional co-operation is essential to best target the relevant scale for investment.

Lessons learned

Although Korea displayed the fastest economic recovery among OECD member countries, it is not clear to what extent the fiscal package contributed to the recovery. To achieve the goal of front-loading, part of the budget was executed faster than expected. From January to June 2009, an "Emergency Desk for Speedy Budget Execution" was established both in the Ministry of Public Administration and Security (MOPAS) and the Ministry of Strategy and Finance (MOSF). Local governments made daily reports to the desk about the status of emergency expenditure. This has certainly helped to quickly infuse public funds into the private sector, but, in the process, the plans of some projects were not reviewed sufficiently. More information on project assessment and implementation methodology will be collected both at central and local levels.

In the short term, co-ordination among sub-national governments did not stand out as a major challenge as the recovery investment package tended to focus on short-term projects directed by central government ministries. The role of sub-national governments and agencies was therefore limited to complying with the instructions and financial support of the central government. However, the lack of involvement of sub-national governments in the identification of priorities might have limited the potential complementarities across the different types of investments at the local level or the degree to which they targeted local needs well identified in advance.

Whether partial decentralisation or administrative and fiscal federalism constitutes an advantage or not when it comes to providing an emergency response to an economic crisis remains an open question. At least on a nominal scale, the case of Korea suggests that less decentralisation (i.e. tighter control by the central government) contributed to a fast economic recovery. However, it can be argued that other variables are not factored in and the link between tight central government control and fast economic recovery in Korea cannot be stretched too far.

More broadly, the crisis has led to rethinking the role of the public sector in building a healthier economy and strategies for fiscal consolidation. This issue is not being discussed explicitly yet, partly because the government has not announced that "the crisis is over". Once exit strategies will be discussed openly, the issue is likely to be examined, particularly in respect to fiscal reforms (re-allocation of financial responsibility, changes in equalisation policy, grants reforms, fiscal discipline measures, etc.), the reorganisation of sub-national public service delivery (e.g. mergers of sub-national authorities), and reforms linked to local public employment and local civil service (e.g. status, remuneration, staff increases or decreases, etc.).

Notes

1. *i)* The three lower personal income tax rates were reduced in 2009-10 by 2 percentage points from a range of 8-26% to 6-24%. The cut in the top rate of 35% was delayed until 2012; *ii)* the corporate income tax rate (national and local) was cut from 25% to 22% in 2009, pushing it well below the OECD average of 28%. The planned reduction to 20% was delayed until 2012; *iii)* the corporate income tax rate for SMEs was reduced from 11% in 2008 to 10% in 2010.

2. The following data come from the Ministry of Public Administration and Security (MOPAS) and the Parliament's Budget Office.

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Chapter 6

Spain

Macro dimension

Impact of the economic crisis on Spain

Spain experienced a period of sustained economic growth before the global financial crisis hit in the second half of 2008. Spanish GDP declined by 3.6% in 2009 and was expected to contract by another 0.5% in 2010. With negative growth rates throughout 2010, the economic downturn in Spain will be longer than in most other OECD member countries (OECD, 2010).

While global developments undoubtedly played an important part, Spain's economic crisis is also attributable to domestic imbalances. A sharp fall in interest rates since the mid-1990's and favourable fiscal treatment for house ownership fuelled a domestic real estate bubble that burst when the global crisis hit.[1] Cheap credit also triggered a consumer spending spree which went hand in hand with a record current account deficit of 10% of GDP in 2007.[2] In the second half of 2008 domestic consumption and investment in housing contracted drastically (IMF, 2006).

The crisis contributed to a significant increase in unemployment in Spain. Job losses which began in the construction sector quickly extended to other parts of the economy. The unemployment rate increased from 8.8% in December 2007 to 18.1% in June 2009 (OECD, 2009). The rise in the number of unemployed in Spain alone accounted for 45% of the newly unemployed in the European Union (ILO, 2010). Specific groups, most notably youth, low-skilled and temporary workers had to bear the brunt of the declining demand for total work hours. This is especially problematic since these groups often lack access to social protection. The unemployment rate for young people reached 44.5% in December 2009. Similarly, foreign workers have been hit very hard, with the number of unemployed increasing from 383 000 in early 2007 to 1 million in mid-2009 (ILO, 2010).

The territorial impact of the crisis was not the same across the country. Preliminary analysis from the OECD indicates that in Spain, while urban regions suffered the largest absolute impact on job losses, the relative impact appears larger in intermediate remote regions (OECD, 2010). The housing market was particularly affected in regions like Catalonia and the Balearic islands whereas it got off lightly in the more sparsely populated regions like Extremadura (La Vanguardia, 2008).

Stimulus measures

Measures adopted to support the financial sector amounted to 14.3% of GDP. In addition, the Spanish Government launched a number of economic stimulus measures in November 2008 that became collectively known as "Plan E". These stimulus measures totalled EUR 11 billion, about 1.1% of 2008 GDP (ILO, 2010).

Funding for local investments amounted to EUR 8 billion and accounted for 73% of these stimulus measures. Means for military housing and provincial welfare programmes made up for 8% of the available funding. Environmental projects and the automotive sector accounted for 7% each and research and development projects represented 5%.

Budget deficits

As a result of expansionary fiscal policy and lower revenues, Spain's general budget deficit reached 11.2% in 2009. It was expected to improve to 9.9% of GDP in 2010 as the government carried out its announced austerity measures (Economist Intelligence

Unit, 2010). Public debt reached 53.2% of GDP in 2009 but stood well below the EU average. Rather than the total public debt it is the rate at which it is increasing in combination with high levels of personal indebtedness and an elevated current account deficit that poses concern.

Planned exit strategy

Ushering the phase of fiscal consolidation, the *Real Decreto Ley* of May 2010 introduced a series of measures aimed at improving the dire state of public finances. These measures include cutting public sector pay by 5% and freezing pension payments as well as raising the value-added tax and the capital income tax. The Spanish Government intended to reduce its deficit by 0.5% of GDP in 2010 and by an extra 1% in 2011. In total, savings are expected to amount to EUR 15 billion over the 2010-11 period (Economist Intelligence Unit, 2010). Public consumption and investment are expected to fall again in 2011 as a result of spending cuts. Like other OECD member countries, the government is thus faced with the difficult task of soothing investor concerns without stifling economic recovery.

Design of the public investment measures

Key Spanish public investment priorities

The Spanish "Plan E" focuses primarily on investment measures, although it also includes a series of tax cuts as well as measures facilitating access to credit. As mentioned, the EUR 8 billion State Fund for Local Investments accounts for the lion's share of the Spanish stimulus measures and focuses on infrastructure investments. Of the initiatives financed by this fund, approximately 32% were investments in the renovation and improvement of public spaces, 29% were investments in basic infrastructure and 17% were dedicated to cultural, educational and sporting facilities and buildings. The remaining funding was used for social, healthcare and funeral facilities; the promotion of road safety; the conservation of historic heritage; the elimination of architectural barriers and energy-efficient renovations of buildings while EUR 79 million are designated for improving industry. Investments in research and development foreseen by the "Plan E" amount to EUR 500 million. EUR 132 million will be addressed to building innovation infrastructure, EUR 92 million for improving the entrepreneur initiative and EUR 219 million for IT tools.

The State Fund for Local Investment was intended to rapidly counteract the deleterious impact of the economic crisis on the labour market. For this reason, investments were targeted at the sectors of the economy that had shed most jobs and deadlines for the implementation of projects were tight. The period of project applications for the Local Investment Fund started on 10 December 2008 and ended on 24 January 2009, leaving little time for strategic planning. Projects needed to start between the 11 January 2009 and 12 April 2009 and end within the first quarter of 2010 (ILO, 2010). Only projects that were not already included in the 2009 budget were eligible of funding. In addition, all newly employed workers for any of the funded projects needed to be registered as unemployed.

Without including indirect employment, the State Fund for Local Investment is expected to have created 426 240 jobs between 2009 and July 2010 (*Ministerio de Politica Territoria*l, n.d.). The plan seems to have been successful as a job creation tool (ILO, 2010). To promote a more sustainable path of economic growth, the Spanish Government launched a new EUR 5 billion Local Investment Fund for 2010 that focuses on more long-term objectives, such as energy efficiency and vocational training.

Involvement of sub-national governments

The State Fund for Local Investment did not require matching funding from sub-national governments. All projects were entirely financed by the national government (Ministerio de Administraciones Publicas, 2009). In a simple online procedure, explained in more detail below, municipalities applied for funding on the website of the Spanish Ministry of Public Administration. Municipalities were directly responsible for the design and implementation of investment measures and were only bound to a limited number of national requirements. The involvement of the regional level in the design and implementation of investments was marginal.

Transparency

Information on the State Fund for Local Investment as well as an up-to-date evaluation of the plan are available on the website of the Ministry of Territorial Policy (*www.mpt.es*).[3] The government also created a portal that provides information on the stimulus plan: *www.plane.gob.es*.

Implementation of the public investment scheme

Implementation process

To apply for funding from the State Fund for Local Investments, municipalities received a special code number with which they could logon to a webpage of the Ministry of Territorial Policy. In addition to a brief project explanation, municipalities needed to submit electronic documentation showing that the project had been approved by the local government and that the project had not already been foreseen in the 2009 budget. Project applications needed to be submitted between 10 December 2008 and 24 January 2009. The total amount of funding a municipality could receive was limited to EUR 177 per resident. Funding for a single project was limited to a maximum of EUR 5 million. This relatively low funding limit did not allow for truly game-changing investments but was intended to encourage a large number of small-scale projects (Federación Navarra De Municipios y Concejos, 2009).

Within ten days after the electronic application submission, the respective government delegations and sub-delegations in every province (*Delegaciones/Subdelegaciones del Gobierno*) first verified whether the project complied with requirements. The application was then transmitted to the Ministry of Territorial Policy. Within another ten days, the Ministry of Territorial Policy verified the application and decided whether the project would receive funding. The ministry's decision was then published online.

Once authorisation for the project was given by the Ministry of Territorial Policy, the municipality had one month to call for tenders. The tender procedure needed to be open and transparent to ensure equal treatment. The municipality received 70% of the funds at the start of the project in order to make immediate payments to contractors. The

remaining 30% would be disbursed upon completion of the project. Projects needed to be completed by 31 December 2009 but under special circumstances they could continue until the first half of 2010. A further extension of the completion period until the end of 2010 was established in order to guarantee the implementation of all of the projects. Once the project was completed, the municipality needed to provide the Ministry of Public Administration with an estimation of the jobs created by the project. Almost all of the funding, 99.9% or EUR 7.9 billion, was spent within the anticipated period (Ministerio de Administraciones Publicas, 2009).

Public actors in charge of implementing/monitoring at central and sub-central level

The Ministry of Territorial Policy was the central government institution directly responsible for managing and monitoring the State Fund for Local Investment. It assumed this task from the former Ministry of Public Administration. Other central government institutions involved included the Ministry of Economics and the General Comptroller of the State Administration (IGAE), which were in charge of monitoring the implementation of projects. Regional governments (*Comunidades Autónomas)* played a marginal role in designing projects, avoiding redundant or coincident investments; they did not participate in the implementation of projects. The provinces (*diputaciones provinciales*) played their traditional role of supporting and backing the local governments' activity when needed. Government delegations and sub-delegations (*Delegaciones/Subdelegaciones del Gobierno*) verified that project applications of municipalities corresponded to national requirements. Municipalities in turn were directly in charge of project implementation.

Main obstacles and co-ordination challenges across levels of government

Obstacles and co-ordination challenges

Without a doubt, the State Fund for Local Investment provided municipalities with important resources to implement investments. These additional resources helped to revert a trend of declining local government spending compared to regional government spending. Although municipalities are still in charge of the bulk of capital investment, their share in sub-national capital investment has been declining since the late 1990's at the expense of the regional level.[4] Yet, while the fund encouraged new local investments, tight deadlines and a strong emphasis on creating jobs they left little room for municipalities to plan and implement the type of foresighted investments to support long-term growth. Municipalities only had a little more than one month to submit project applications. Nevertheless, the fund was widely known before being formally established and the local governments had many investment needs to fulfil, given the economic situation. As a matter of fact, despite the tight deadlines almost every municipality in the country (8 107 out of 8 114) submitted projects.

Gaps in human and knowledge capacity at the local level, especially in small municipalities, were minimised by the provincial government support actions. In the smaller municipalities, projects tended to cover basic needs (NAIDER, 2009). Some citizen organisations complained about the fact that local needs were not adequately addressed and citizens not sufficiently engaged, but that reflects in most of the cases the political struggle at the local level and the opinion about a certain local government performance (Ecologistas en acción, 2008).

Aside from grappling with facing capacity problems, small municipalities were not advantaged by the fund allocation, which was solely based on the number of residents, as it was seen as the most objective, unbiased and transparent criterion. The allocation of the annual central government transfers, for instance, is based on a variety of criteria, including the need for infrastructure investments, territorial size, the relationship between local revenues and the population and the unemployment level, although these transfers are different to this fund in nature as well as in goals.

Policy co-ordination gaps that might have emerged as a result of limited co-operation between municipalities and the lacking involvement of the regional level planning posed another challenge, even though its scope is considered to be small. In Spain, 4 861 out of the 8 114 municipalities have less than 1 000 inhabitants, a condition which has become known as *inframunicipalismo*. Associations between Spanish municipalities, so-called *mancomunidades* and *agrupaciones de municipios*, allow for the pooling of resources and the exploitation of synergies but their creation has only advanced sluggishly in the past ten years. Municipality associations are not always required to be geographically contiguous and political changes in one of the municipalities have often led to the break-up or a redefinition of the association (Manuel Arenilla Sáez, 2004). In the context of the crisis, the problematic side-effects of lacking co-operation between municipalities became more apparent, but there is no evidence that individual project applications by municipalities engendered a lack of co-ordination between projects which eventually compromised the coherence of stimulus measures, as the complexity of territory organisation encourages deep co-ordination amongst levels of government and administration. While it is true that the State Fund for Local Investment allowed for joint applications, most of the municipalities cast out this possibility. For example, only six out of 1 022 municipality associations applied for project funding (Ministerio de Politica Territorial, 2010). Also, the total of six projects proposed by municipality associations was negligible compared to the whole amount of 30 699 projects (Manuel Arenilla Sáez, 2010).

The co-ordination between projects was not helped by the fact that neither the regional nor the provincial level[5] was actively involved in the investment planning stage. Nonetheless, in the management of previous local investment plans like for example the *Programas Económicos de Cooperación Local del Estado* the regional level had not been intensely involved in the design and planning stage either.

One reason why regions have been left out might have been the need to avoid conflicts among regions concerning the allocation of funding in order to implement the scheme rapidly. Although this political choice is efficient in a context of urgency, it is ambiguous from an economic point of view. By excluding the regional and provincial level from the planning stage of the State Fund for Local Investment, the national government deprived itself of a useful actor in exchange of faster and more coherent intervention. The motivation for limiting the involvement of regional governments in the context of the Spanish stimulus plan might be better understood when looking at the sometimes competitive relations between the central government and the regions in Spain (Box 6.1).

Box 6.1. **Asymmetric decentralisation in Spain**

Strictly speaking, Spain does not qualify as a federal state. Yet, over the last few decades Spain has undergone a process of decentralisation that transferred important powers from the central government to the regions, called autonomous communities (AC). The decentralisation process in Spain was very complex and often conflictuous. Most of the conflict between the central government and the regions stemmed from competition over policy competences. In fact, for each specific transfer of responsibilities, an agreement (*Acuerdo de Traspaso*) had to be signed between the central government and the AC. As a result of historical differences in the autonomy of regions and of bargaining delays, the decentralisation process was asymmetric, adding rivalry between regions to the competition between the central government and regional governments.

Source: OECD (2007), *Linking Regions and Central Governments, Contracts for Regional Development*, OECD Publishing, Paris, doi: 10.1787/9789264008755-en.

Lessons learned

As a job creation measure, the Spanish State Fund for Local Investment seems to have been very successful. It is expected to have created 426 248 jobs, not including indirect employment (as of July 2010). The online application procedure of the State Fund for Local Investment also seems to have been very successful. In fact, the United Nations Department for Economic and Social Affairs honoured Spain with an award in 2010 for its outstanding progress in e-service delivery (United Nations, 2010). In general, the application procedure and the management of the fund seem to have involved very little bureaucratic burden. For example, the general contract law was modified in the context of the stimulus plan to allow for abridged application procedures. Monitoring requirements, including those of the General Comptroller of the State Administration, were also simplified.

The State Fund for Local Investment was not designed to allow for forward-looking investments that would have helped to shift the Spanish economy away from its strong reliance on the construction sector. The Spanish Government identified this gap and realised the need to advance the modernisation and sustainability of the economy and launched a new Local Investment Fund in 2010. The available funding amounts to EUR 5 billion and will be directed at projects that promote more long-term objectives, including environmental sustainability and vocational training. It expects to create around 280 000 jobs.

Nevertheless, a number of challenges remain. The new Local Investment Fund, like its predecessor, does not engage the regional level in the strategic planning of investments, nor does it encourage or discourage inter-municipal co-operation. On the contrary, it is based on the political autonomy of municipalities and the role of provincial governments (*diputaciones provinciales*) in supporting small municipalities. In many OECD member countries, regional actors have proven indispensable in devising territorial development plans that identify investment needs. These plans, while not always legally binding, were useful tools in a situation of urgency that left little or no time for strategic planning.

Notes

1. A 2005 study by the *Economist* found that real estate prices were overvalued by 60%. Initial concerns about the sustainability of Spain's economic growth based on a domestic construction boom and internal consumption surfaced in 2004 when households' debt-to-income ratio reached a record level of 105% surpassing the Euro area's average of 90%.
2. The average current account deficit in OECD member countries amounted to 1.6% of GDP in 2007.
3. In 2009, the Ministry of Territorial Policy assumed the functions of the Ministry of Public Administration (MAP), which became integrated in the *Ministerio de la Presidencia*.
4. The share of local capital expenditure in sub-national capital expenditure declined at the expense of the regional level but the share of local capital expenditure in general government expenditure has roughly stayed the same since the late 1970's.
5. Spain is divided into 17 regions which constitute autonomous communities that represent Spain's regional level. There are also 50 provinces which are part of the above-mentioned autonomous communities.

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Chapter 7

Sweden

Macro dimension

Impact of the economic crisis on Sweden

The decline in international demand hit Sweden's export-oriented economy particularly hard. Swedish GDP decreased by 0.5% in the second half of 2008 and by 4.7% in 2009 before recovering in 2010. Swedish GDP was expected to grow by 2.6% in 2010, but with fiscal policy in neighbouring countries tightening, it is expected to slow down to 1.6% in 2011 (Economist Intelligence Unit, 2010). Unlike the Swedish banking crisis of the 1990's, which had its origin in the collapse of domestic real estate prices, the recent crisis was mainly caused by increased exposure to international markets (Öberg, 2009). Swedish banks had accumulated substantial buffers during the profitable years preceding the crisis and thus weathered the financial turmoil relatively well compared to other countries. Nevertheless, they still experienced several funding problems and required liquidity assistance by the Swedish Government.

In absolute numbers, the most affected regions in Sweden are those exposed to international markets, with a large element of manufacturing industry and services, mainly Västra Götaland, Stockholm and Skåne. Nonetheless, the economic base in these regions is more diversified and they are more likely to bounce back quicker once the overall level of demand recovers. In proportional terms, the impact of the crisis is larger in undiversified regions with thin markets and high dependence on few sectors. In particular, the proportionate impact has been larger in the regions adjacent to metro regions and in more sparsely populated regions in the south which have thinner markets and less diversified economies (OECD, 2010). This relationship is reflected in the regional labour markets. While the largest unemployment increases in absolute terms have occurred in the metro regions, the proportionate effect has been larger in the adjacent regions and other regions dependent on the export industry.

Although Sweden entered the crisis with a fiscal surplus and strong financial results and with greater room to manoeuvre than many OECD member countries, the budget situation has deteriorated as a result of the crisis. In the short term, local governments are the most directly affected, with a combined decrease in tax revenues (in fixed prices) and an increase in the number of recipients of social benefits (owing to the increase in unemployment) (OECD, 2010).

Stimulus measures

To stabilise financial markets, the Swedish Government expanded deposit guarantees and provided banks with liquidity assistance in the form of loans.[1] In total this lending amounted to over SEK 450 billion (Öberg, 2009). The Swedish Government has also launched several measures to stimulate the real economy amounting to SEK 83 billion or 2.7% of GDP. Around SEK 48 billion were foreseen for 2009 and a further SEK 35 billion for 2010.

Investments account for around 5% of these stimulus measures and include funding for research and development in the automobile sector (SEK 23 billion) as well as funding for infrastructure investments (roads and railway, SEK 1 billion) and vocational education.[2] Tax cuts, labour market measures and support for the automobile sector account for the largest part of the stimulus plan (see Annex 7.A1). One of the biggest beneficiaries of the stimulus plan is the Swedish automobile sector. Apart from the above-mentioned investments in research and development it also received rescue loans amounting to SEK 5 billion as well as credit guarantees in the amount of SEK 20 billion

for the development of green technology. The stimulus plan also includes a total of SEK 7 billion in the form of a general purpose grant for Swedish municipalities whose budgets were severely strained by the financial crisis.

Sweden has adopted several measures to attenuate the impact of the crisis for sub-national governments. The government presented these proposals in the 2009 Spring Fiscal Policy Bill[3] and the 2010 Budget Bill.[4] Support is expected to enable local authorities to secure the provision of fundamental welfare services when their financial situation is deteriorating as well as prevent pro-cyclical local policy which could deepen the general economic downturn (OECD, 2010). For 2011 and 2012, the government proposes to allocate an additional government grant to local authorities of SEK 5 billion each year compared to the level of central government grants in 2009.

Budget deficits

Following five years of surpluses, Swedish public finances worsened in 2009 as a result of falling revenues and the stimulus measures in response to the crisis. The fiscal deficit reached 0.9% of GDP in 2009 and was expected to rise to 2.1% of GDP in 2010. The consolidated gross debt is estimated to reach 47% of GDP at the end of 2012. Even though this is an increase, it compares favourably to the fiscal situation in most other OECD member countries and remains under the reference value of 60%, an EU requirement (Swedish Ministry of Finance, 2009).

Exit strategy

Public spending in Sweden is constrained by a surplus target and expenditure ceilings. The surplus target stipulates that general government revenue minus expenditure must not fall below 1% of GDP over a business cycle, which is evaluated based on a number of indicators, most notably average net lending and the structural balance. Government expenditure ceilings are determined three years in advance and must comply with the surplus target. In addition to the surplus target and expenditure ceilings which are directed at the central government, local governments in Sweden are required by law to have balanced budgets (Swedish Ministry of Enterprise, Energy and Communications, 2009).

Tax credits for construction work was a temporary measure (until the end of 2010). However, the tax credit was expected to turn into a permanent measure from 2011. State credit guarantees to the automobile sector were planned to be provided until the end of 2010. The rescue loans for the automobile sector is a temporary measure, but no decision is yet taken on when this measure will come to an end.

Design of the public investment scheme

Key Swedish public investment priorities

Investment measures, which account for approximately 5% of the stimulus plan, are being carried out in three main areas. Around SEK 23 billion are being invested in research and development within the automobile sector. Specific clusters have been targeted, especially the automobile industry in Västra Götaland region and Blekinge County. According to the National Accounts, investments in railroads amounted to SEK 18 billion and in roads SEK 11 billion in 2009. Investments in post-secondary vocational training total SEK 500 million.

Involvement of sub-national governments

Unlike investment measures in Canada, Germany and the United States, the Swedish measures did not require local governments to match central government funding, that is to contribute financially to the investment measures.[5] Given that the central government traditionally provided investment funding, it also played a dominant role in identifying investment priorities. Yet, the crisis revealed the need for appropriate co-ordination mechanisms at the regional scale to implement growth strategies. In this context the Swedish Government established regional co-ordinators.

Sweden started an experience with regional co-ordinators in early 2008 that was extended to all counties when the crisis hit Sweden in fall 2008. The aim has been to facilitate and strengthen the co-ordination of local, regional and national actors, policies and resources, at a scale that was considered by national policy makers crucial to deal with the crisis. The function of regional co-ordinator was carried out by the respective county governor and a regional political leader. Together they have been in charge of regularly reporting to the government about the economic developments in the county and identifying areas that require government support, as well as taking action within their means to handle the crisis regionally. While the functions of county governors and regional politicians were in place before, it is their collaboration in communicating with the central government which is novel. Due to the recovery from the crisis, the regional co-ordinators finished their duties during the autumn 2010. Their tasks are now carried out and developed within ordinary regional development work.

The work initiated by the regional co-ordinators has also shown that established regional partnerships and long-term strategies have been crucial to speed up decision making at a time of crisis. County administrative boards and regional co-ordination bodies also contributed indirectly to the selection of investment priorities in the context of the recent stimulus plan since they had been involved in the design of regional development programmes and regional growth programmes starting in the early 2000's which proved to be useful tools once the crisis hit. Although these programmes lack enforcement capacity (as they are not attached to any specific budget), they represented long-term strategies that authorities could fall back on in a situation of urgency.

Key governmental actors involved

The global crisis has also highlighted the need for better co-ordination on regional development issues at the national level. To facilitate communication between the regional co-ordinators and the central government agencies responsible for investment – most notably the Swedish Public Employment Service, the Swedish Agency for Economic and Regional Growth and the National Agency for Higher Vocational Education – an inter-ministerial group of state secretaries was set up. The group of state secretaries has received the regional co-ordinators' proposals and been in charge of facilitating the co-ordination within the responsible ministry.

Box 7.1. **Institutional framework and asymmetric regionalisation process in Sweden**

The Swedish Constitution only mentions two levels of governments: local and national. The County Council is directly elected by the citisens of the county.

County governors represent the national government at the local level: they head the County Administrative Board appointed by the central government. Its responsibilities include the implementation of national policies and to some extent the promotion of regional development.

Sweden's decentralisation in recent years has been a largely bottom-up process, as the government has not imposed a single model on the counties. Since the late 1990's, Sweden has developed different decentralisation options in different counties, i.e. decentralisation has been pursued in an asymmetric manner.

In the late 1990's, the Swedish Government approved two pilot regions in the newly formed counties of Västra Götaland (including the city of Göteborg) and Skåne (including the city of Malmo). In these counties, directly elected regional county councils took over part of the responsibilities of the county administrative boards (including strategic planning and regional development).

In the early 2000's, municipalities were given the option to form regional co-ordination bodies that would share the task of developing regional growth policies with the county administrative boards. These regional co-ordination bodies are indirectly elected.

In early 2008, immediately before the outbreak of the global financial crisis, the Swedish Government appointed regional co-ordinators in Norrbotten and Gävleborg to help harmonise regional growth policies. When the crisis hit Sweden in the fall of 2008, the government extended the position of regional co-ordinator to all counties in Sweden to help tackle the increased co-ordination demands. The regional co-ordinators regularly report to the government about the situation in the county, identified and implemented actions and identified needs of governmental interventions.

Source: OECD (2010), *OECD Territorial Reviews: Sweden 2010*, OECD Publishing, Paris, doi: 10.1787/9789264081888-en.

Public private co-operation

There have been no special schemes to promote public-private partnerships in the context of the recent investment measures. Even so, the dialogue between public and private actors, although not always formalised, is probably more systematic in Sweden than in most other OECD member countries (OECD, 2010). Among Sweden's strengths is a high level of trust in public authorities, a characteristic which facilitates public-private co-operation. It plays a key role in the successful implementation of innovation programmes such as the VINNVÄXT programme, which is based on a "triple helix" model of collaboration by public and private actors and universities. They also play a major role in building social capital (interaction among actors). For example, although northern regions may be disadvantaged because of low agglomeration economies and long distances to markets, they have strong social capital; public and private actors co-operate relatively easily because they know – and trust – each other.

Transparency

Information on the coverage and design of the stimulus packages is available on the website of the government *www.sweden.gov.se/sb/d/11500*. Sweden considers transparency as a key element of the successful implementation of its recovery strategy, and it is also a lesson that it drew from the crises of the early 1990's. On the transparency dimension, Sweden has strengths which are linked to its national policy-making "culture", as Sweden ranks among the highest in the world in terms of trust in government, transparency and consensus building. Sweden ranks second out of 133 countries on the transparency index in the 2009-10 *Global Competitiveness Report*. It is also in second place for the overall quality of its public institutions (OECD, 2010).

Implementation of the public investment scheme

The inter-ministerial group of state secretaries and the regional co-ordinators have played important roles in the **implementation** of investment measures. The Swedish transport administration has also been particularly involved.

As of 1 January 2010, between 25% and 50% of planned investment for roads and railways had been implemented (no data is available for other areas than roads and railways). There is no specific sunset clause in the use of additional national investment funding in Sweden. The investment measures were mainly small, bordering to maintenance measures. This meant that the measures chosen did not require a long time for preparation and could be implemented with short notice.

Table 7.1. Implementation of investment projects of the national investment package launched during the crisis

Planned timeframe	Planned implementation of investment (% of total investment package(s)					
Investment to take place by the end of:	Less than 10%	10-25%	25-50%	50-75%	More than 75%	No approximation possible
2009			x			
2010			x			
2011		x				

Source: Answers to OECD (2010), "OECD Questionnaire Response, Making the Most of Public Investment Recovery Strategies, Multi-Level Governance Lessons from the Crisis", OECD, Paris.

Main obstacles and co-ordination challenges across levels of government – lessons learned?

Obstacles and co-ordination gaps

Policy gap

Sweden's multi-level governance system is sometimes compared to an "hourglass"[6] in which the central government and the municipal level hold the majority of powers, while the intermediary regional level is relatively weak. The regional level is represented by the county councils whose main responsibility lays within the health care sector but whose involvement in the development of regional growth strategies is limited. For example, investments in regional development only accounted for 6.6% of the county councils' net expenditures in 2009 (Statistics Sweden, 2009). The central government, on

the other hand, is responsible for almost half of public investment compared to less than 30% in most other OECD member countries (DEXIA, 2008).

A centralised framework for public investment has both advantages and drawbacks. It may allow for more efficient decision making, but it can also limit the degree to which local governments are able to match investment priorities with local needs (OECD, 2010). The Swedish Government realised the need for engaging elected regional authorities to better tailor investments to the local context and began to selectively devolve policy competencies to the regional level in the 1990's[7] (see Box 7.1). The crisis has further highlighted the need to better involve the regional level in the development of growth policies.

Administrative gap

The implementation of the stimulus plan also drew attention to administrative gaps resulting from a mismatch of administrative borders and functional regions. Like in most OECD member countries, administrative borders in Sweden do not necessarily correspond to the **functional** nature of the region, which is the logical basis for regional economic development. This mismatch is especially apparent in the south of Sweden where the small size of the counties made a more integrated regional growth policy difficult. Short of designing new administrative boundaries, which may turn out to counteract long-term growth strategies, strong inter-regional co-ordination can help exploit the advantages of functional regions, such as good transport connections, high levels of social capital, strong social cohesion and good communication infrastructure (OECD, 2010).

Fiscal gap

Like many OECD member countries, the fiscal situation of local governments in Sweden has raised challenges for the recovery strategy. Local tax revenues in Sweden are particularly sensitive to economic downturns since they stem from a single source – a flat tax on residents' income (OECD, 2010). As a consequence of the pro-cyclical nature of local tax revenue, the fiscal situation of local authorities deteriorated in the wake of the financial crisis, and due to the lagged effect of the crisis, the effect on sub-national finances in 2010 and 2011 could be significant, especially for counties. This has been especially problematic since local authorities account for 25% of employment in Sweden. The government thus had to intervene with temporary grants to prevent over 9 000 people from losing their jobs and to enable local authorities to provide fundamental welfare services.

Swedish local governments have a limited margin of manoeuvre to deal with the crisis as the Local Government Act states that municipalities and county councils must have balanced budgets. Sub-national governments (counties and municipalities) have limited fiscal options for dealing with the crisis: either balance their budgets by reducing expenses (cutting jobs and investments) or increasing revenues (raising taxes), or they try to implement counter-cyclical policies thereby exposing themselves to a higher debt burden. The room for significant increases in tax rates seems limited, given the already high rates of taxation in Sweden. This makes it all the more important for municipalities and county councils to intensify their efforts to improve efficiency, rationalise their services, but also to better exploit local assets to enhance regional growth. The crisis also raises questions for Swedish local finances, such as the need for sunset clauses for temporary grants or the need to revise the balanced budget rule. In the 2010 Budget Bill

the government announced that the issue of increased stability for local government revenue over the business cycle will be examined (OECD, 2010).

Lessons learned

The crisis highlighted the need to have well-developed co-operation mechanisms across levels of government to best target and implement public investment. In Sweden, the collaboration across the national government, regions and municipalities is reported to have been "high". The regional co-ordinators which were established across all Swedish counties to help design and implement the recent stimulus measures proved to be of value.

A second lesson that crystallised as a result of the recent crisis experience is the need for increased horizontal co-operation at the central level. Horizontal co-operation is crucial in developing territorial growth strategies which are increasingly seen as necessary complements to sectoral approaches. The newly established inter-ministerial group of state secretaries forged such horizontal co-operation and also served as a contact point for regional co-ordinators. The inter-ministerial group of state secretaries at the national level proved to be very efficient with quick and smooth decision making across different ministries.

A general lesson that the Swedish Government raised is that clear national and regional leadership are crucial in crisis management. In that sense, the clarification of responsibilities of actors involved in the crisis management, such as the inter-ministerial group of state secretaries as well as the regional co-ordinators, was essential. With well-functioning partnerships and a continuous dialogue, the responsibilities of different actors are made clearer and co-ordination becomes easier.

The existence of previous regional development programmes and regional growth programmes also proved to be highly useful in the context of the crisis. At a time of urgency, it has proven useful to rely on pre-existing regional strategies that have identified investment priorities for regions in a multi-year perspective and in a cross-sectoral perspective. These priorities need to be complemented with the ability to be flexible and adjustable to new challenges. A challenge for the future is in fact to give a greater role to regional development programmes with stronger enforcement tools, standardised timelines, and to clarify the financial framework in which they are operating (OECD, 2010).

The lessons that Sweden was able to draw from the crisis of the early 1990's have also proven critical, notably in terms of showing no hesitation from the government's action, fiscal prudence and responsibility, protecting taxpayers' interest and enhancing transparency on the problems being tackled and the measures adopted. The Swedish Government proved to be agile in the context of the recent crisis like it did in the 1990's. Following the banking crisis of the early 1990's, Sweden carried out a series of reforms (pensions, reforms in the health and education sectors, reorganisation of agencies) to improve the sustainability of the welfare state model and the efficiency of public services.

Notes

1. The Carnegie Investment Bank AB also received liquidity assistance from the Swedish Government. Because its funding problems persisted, the Swedish financial supervisory authority *Finansinspektionen* initially revoked Carnegie's licence to conduct banking activities. Eventually the Swedish National Debt Office took control over Carnegie.
2. Percentage is calculated based on information provided by the Swedish Ministry if Enterprise, Energy and Communications, see Annex 8.A1.
3. In the 2009 Spring Fiscal Policy Bill, the government proposed to give a temporary grant of SEK 7 billion to local authorities (municipalities and county councils) in 2009. These funds were intended to be delivered in December 2009 and used in 2010. The government expected the temporary cyclical support of SEK 7 billion in 2009 to prevent over 9 000 local public employees from losing their jobs (SALAR, 2009).
4. In the 2010 Budget Bill, the government proposed a temporary increase in central government grants to local governments of SEK 10 billion for 2010 in order to moderate the fall in local employment and mitigate the effects of the economic crisis.
5. However, if additional support is provided after 2010, it is expected that municipalities will contribute with matching arrangements.
6. McCallion (2007), the Swedish Constitution only mentions two levels of governments: local and national. However, since the 1862 reform, counties have had an elected council which is independent from the national government.
7. For further information please see OECD (2010).

Annex 7.A1

Table 7.A1.1. Swedish stimulus measures in response to the crisis (billions SEK)

	2009	2010	2011	Total
Questionnaire	48	35		83
Infrastructure investments	0.4	0.4	0.2	1
Tax credits for construction works				3.6
Research for automobile industry				3
State credit guarantees to automobile sector for development of green technology				20
Rescue loans for the automobile sector				5
Unemployment insurance				10
Swedish Public Employment				0.3
Work placement scheme and practical skills development				2.4
Coaching				1.1
Education and Training				0.5
Support to local authorities				7
				53.9

Source: Memorandum of the Ministry of Enterprise, Energy and Communications.

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Chapter 8

United States

Macro dimension

Impact of the economic crisis on the US economy and sub-national governments

The 2008-09 financial crisis and recession inflicted considerable damage to the US economy – most notably a significant tightening of credit and the loss of one-quarter of household net worth between the middle of 2007 and early 2009 (OECD, 2010a). The US has lost more than 8 million jobs since the beginning of the crisis; the unemployment rate had risen to 10.1% by the end of 2009. Most states have suffered significant job losses. According to the analysis "Geography of a Recession" published in the New York Times, job losses have been most severe in areas that had experienced a big boom in housing, those that largely depend on manufacturing and those that already had the highest unemployment rates before the crisis (New York Times, 2010). H However, the economic recovery in the United States from arguably the most significant recession since the Great Depression of the 1930's is underway, amid substantial economic stimulus, but uncertainty remained high in mid-2010 on the pace of recovery (OECD, 2010a).

Sub-national governments (SNGs, states and municipalities) have been severely hit by the crisis in the United States and their fiscal situation remains critical. Two key considerations in assessing the fiscal impact of the crisis on states are that many states and localities are highly dependent on particular revenue sources (e.g. property taxes for many municipalities), and that they are almost all constitutionally required to balance their budgets. The crisis has considerably reduced state revenues and state budget gaps (i.e. difference between desired spending and projected revenues) have reached unprecedented levels. These gaps are projected to last at least until 2012 as sub-central tax revenues usually take longer to recover in the United States than GDP growth. States foresee the 2011 fiscal year (starting on 1 July 2010 for most states) to be the most difficult in decades with little improvement expected for 2012 (McNichol, Oliff and Johnson, 2010). According to the General Accounting Office (GAO), deficits for sub-national governments will reach USD 39 billion for 2010 and USD 124 billion for 2011, while SNGs will no longer be able to count on the American Recovery and Reinvestment Act (ARRA) funds to bridge these gaps. The cumulative two-year projected operating deficit totals approximately USD 163 billion (GAO, 2010a).

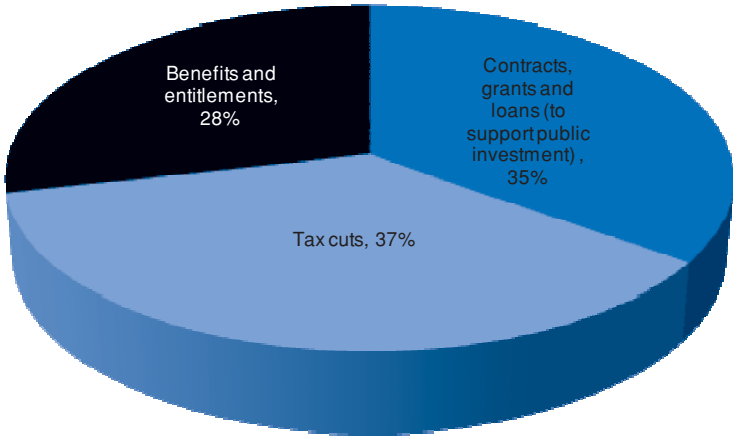
Stimulus measures

The federal government responded to the crisis with extraordinary fiscal interventions. In addition to large injections into the financial sector in late 2008,[1] the ARRA was adopted in February 2009. The ARRA recovery package amounts to USD 787 billion and was one of the largest stimulus packages in OECD member countries (with Korea). It represents about 5.5% of the 2008 GDP. Of the USD 787 billion recovery package, USD 275 billion, was allocated for contracts, grants and loans – partly aimed at supporting public investment measures, which amount to 35% of the recovery package. The remaining funds are allocated for tax cuts (USD 288 billion) and mandatory spending, such as funds for education, healthcare and unemployment (USD 224 billion) (Figures 8.1 and 8.2).

Box 8.1. **Objectives of the American Recovery and Reinvestment Act (13 February 2009)**

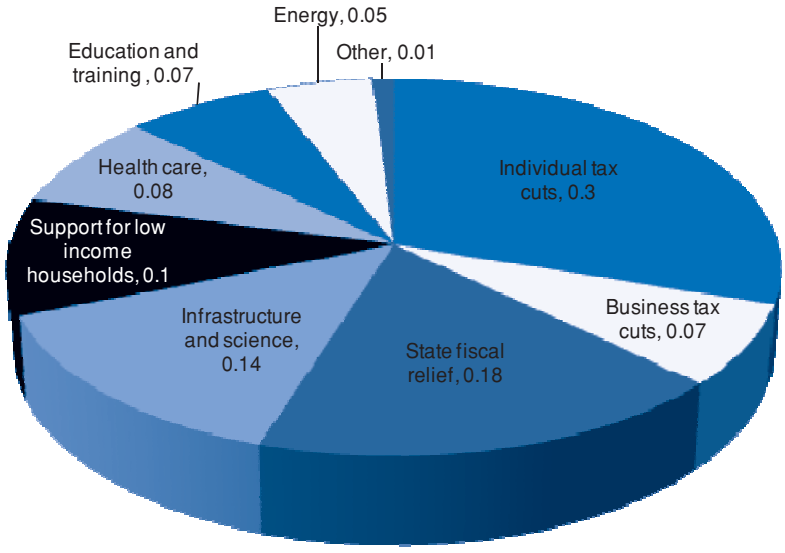
ARRA has five goals stated in Section III of the act: *i)* to preserve and create jobs and promote economic recovery; *ii)* to assist those most impacted by the recession; *iii)* to provide investments needed to increase economic efficiency by spurring technological advances in science and health; *iv)* to invest in transport, environmental protection and other infrastructure that will provide long-term economic benefits; and *v)* to stabilise state and local government budgets, in order to minimise and avoid reductions in essential services and counterproductive state and local tax increases.

Figure 8.1. **Breakdown of ARRA stimulus measures (total: USD 787 billion)**



Source: www.recovery.gov.

Figure 8.2. **Sectoral composition of the ARRA stimulus package of 2009 (total: USD 787 billion)**



Source: www.recovery.gov and Irons, John S. and Ethan Pollack (2009), "The Recovery Package in Action", *EPI Briefing Paper 239*, Economic Policy Institute, Washington, D.C.

Role of sub-national governments (SNGs)

Out of the USD 787 billion stimulus plan, USD 286 billion is administered by states and municipalities (GAO, 2010a), divided about equally between general fiscal relief (for education, Medicaid, welfare expenditures) and specific investment funding meant to stimulate the economy (Inman, 2010). For investment support, the ARRA provides funding that supplements state spending (for transport,[2] education,[3] job training, etc), as well as funding for competitive grant opportunities, for energy and broadband for example.

Budget deficits

As other OECD members countries, the United States is exiting the recession with a large budget deficit and a rising public debt. According to the *Economic Survey of the United States* (OECD, 2010a), the US budget deficit widened by about 9% of GDP from 2006 to 2009, the federal deficit was estimated to exceed 10% of GDP in both 2009 and 2010, and the federal debt held by the public will reach the highest level since the early 1950's (OECD, 2010a: 21). The administration has proposed to reduce the federal deficit from about 10.5% of GDP in 2010 to 3% in 2015, which would stabilise the debt-to-GDP ratio (OECD, 2010a). Measures have been identified to cover part of the fiscal effort and a bi-partisan commission was mandated to suggest complementary actions. It will nonetheless leave the debt-to-GDP ratio at about twice the pre-crisis level, leaving little freedom to deal with contingencies and further complicating the long-term problem of population ageing (OECD, 2010a).

Policy debates (as of September 2010): a new infrastructure investment plan

Most of the ARRA stimulus funding was planned to be spent in 2009-10, quickly enough to support the recovery. The total fiscal impact of ARRA is spread out over a number of years, with three-quarters of the package concentrated in the first two years, as estimated by the Congressional Budget Office. Although the fiscal situation of the country – in particular the rising federal deficit – calls for fiscal consolidation measures in the medium-term,[4] the uncertainty over the recovery of the American economy makes it difficult to implement fiscal consolidation in the short term and necessitates prudence. Recent indicators on the American economy have been mixed, but the housing market is showing persistent difficulties and the unemployment rate is almost 10% (9.6% in August 2010). The Obama administration has implemented different measures to support employment in addition to the ARRA recovery strategy. Multiple new job programmes have already been passed since the Recovery Act, including a new tax credit for hiring unemployed workers, tax breaks for small business investing, a lending fund to increase small businesses' access to capital, multiple extensions of unemployment insurance and additional aid to states. Given the time it takes for these measures to be fully beneficial and the persistent difficulties on the labour market, in November 2010 the Federal Reserve Bank announced a massive round of long-term bond purchases (USD 600 billion in long-term treasuries). The Federal Reserve Bank also announced it will reinvest an additional USD 250 billion to USD 300 billion in treasuries with the proceeds of its earlier investments. This "quantitative easing" will total USD 900 billion and be completed by the end of the third quarter of 2011.

On 7 September 2010 President Obama announced a package of roughly USD 180 billion in expanded business tax cuts[5] and infrastructure spending. Congress would need to approve any new package, and it is not certain that they will adopt it following the recent elections. This new package would include a USD 50 billion investment in America's transport infrastructure to spur the economy and create jobs. The plan builds upon the infrastructure investments that were made through in the Recovery Act. The proposal calls for investments over six years, including rebuilding and modernising 150 000 miles (241 350 kilometres) of roads, 4 000 miles (6 430 kilometres) of railways and 150 miles (241 kilometres) of runways. The plan also proposes to set up a government-run infrastructure bank to leverage federal money with state, local and private sector investments to finance projects, and to focus on the smartest investment. The infrastructure plan is intended to serve as a "down-payment" on a longer term infrastructure programme that will be initiated as part of a six-year reauthorisation of the federal surface transport programme.

Design of the public investment scheme

Involvement of sub-national governments

One-third of the total ARRA funding is administered by SNGs (GAO, 2010a). The challenge for all programmes is that states have to act **quickly**. For federal programmes, states must spend these additional funds in the specified programme areas (education, Medicaid, federal infrastructure programmes, etc.). There are no one-way money flows from the federal government to state and local governments. In some cases, it is formula-driven where agencies like Education and Transportation allocate dollars to the state. While states must spend funds in specific areas, they typically have significant discretion in how their particular programmes are designed (where they build roads, how they allocate education funds, etc.). For funds that states have obtained through

competition (for example in the areas of energy, green growth, broadband development, R&D and health IT), even where there is significant flexibility in the guidelines for competitive grants, states are often committed to specific uses when they receive their funds because their applications typically specify what the funds will be used for.[6]

To ensure that federal spending does not simply replace state spending, a key requirement is the maintenance-of-effort provision. A number of programmes in the Recovery Act contain new maintenance-of-effort provisions spanning the areas of transport, education, housing and telecommunications. These are important mechanisms to help ensure that federal economic stimulus spending achieves its intended effect of providing countercyclical assistance and increasing overall spending and investment.[7] For transport, the governor of each state had to certify that the state will maintain its level of spending for the types of transport projects funded by ARRA it planned to spend the day the Recovery Act was enacted.[8]

Key priorities for investment

ARRA has been designed in a way to be timely, targeted and temporary.

Timely: rapid adoption of ARRA

ARRA had to be adopted rapidly given the context of urgency. To accelerate the design of the ARRA programme, existing government agencies and government programmes have been mobilised, rather than creating new programmes from scratch. This is in particular true for federal school aid, personal transfers and infrastructure. Relying on existing structures has helped reduce complexity (helping to avoid waste and administrative burden) and allowed for faster, more effective implementation. It has also helped to avoid opening up an unstable redistribution game between all legislators (Inman, 2010). It is also important to note, however, that some new programmes **were** created to help advance new policy objectives, including programmes for broadband infrastructure, clean energy and health information technology.

Temporary: limited timeframes for execution

For investment projects, most funds for states and municipalities had to be obligated within one year (by 30 September 2010)[9] and a Recovery Act requirement is to give priority to projects that can be completed in three years (beginning in FY 2009 and ending in FY 2011). The emphasis has been on projects that are "shovel ready", which in practice means ready to go out for design and construction bids by September 2010 or sooner. According to the GAO, the actual **spending** path is likely to stretch out into the coming decade, given the time it takes to execute investment projects[10] (GAO, 2010a and 2010b). The legislation includes programme-specific use-it-or-lose-it clauses that require states to obligate available funding within a specified timeframe to prevent reappropriation to other states (Inman, 2010).

Targeted: areas and sectors

About one-third of ARRA funding has been allocated to public investment[11] as a way to support employment and enhance long-term growth. Spending is in priority directed for traditional areas of federal capital investment such as transport (in particular construction and repair of roads and bridges) and water resources. The Recovery Act appropriated USD 26.6 billion for highway and USD 8.4 billion to fund public transit for states and municipalities (see Table 8.A1.3 in Annex 8.A1 for more information).

However, ARRA also aims to transform the American economy through innovation and enhance green investment, in particular in the areas of energy. Within the reinvestment spending of the Recovery Act, over USD 100 billion is invested in innovative and transformative programmes. Game changing investments include:

- modernising transport, including advanced vehicle technology and high-speed rail (USD 8 billion will be spent for high-speed rail projects);
- jumpstarting the clean energy sector through investments in renewable energy and energy efficiency;
- building a platform for private sector innovation through investments in broadband, Smart Grid and health information technology; and
- investing in groundbreaking medical research.

Certain programmes within the Recovery Act have additional provisions to target particular sectors. For example, the Recovery Act requires that at least 20% of funds provided to each state's State Revolving Funds be used to fund projects that include green infrastructure, water or energy efficiency improvements, or other environmentally innovative activities (Recovery Act, 123 Stat. 169).

The allocation of funding across states has been balanced so that all types of states (both those with much of their population in metropolitan areas and those with large rural populations) receive significant funding, to balance the different interests (Inman, 2010). ARRA selected some programmes that favoured urban states – such as Medicaid support and the public transit programme – some that favoured rural states – such as highway aid, and others that favour high-poverty areas. ARRA aims to give priority to projects that are located in economically distressed areas as defined by the Public Works and Economic Development Act of 1965.[12] For infrastructure investment, the Recovery Act requires all states to dedicate the funding to specific areas. For example, in the Highways Programme, 30% of the funding has to be sub-allocated, primarily based on population, for metropolitan, regional and local use.

Accountability and transparency

One of ARRA's goals is to increase the transparency and accountability of inter-governmental fiscal relations (United States Government, n.d.). The legislation contains numerous provisions to ensure that the appropriated funds are spent as intended by the Congress. State activities are subjected to extensive public scrutiny and to enhanced oversight by a variety of federal entities, including federal programme managers, agency inspectors general and the Government Accountability Office. Federal efforts are co-ordinated by a newly established **Recovery Accountability and Transparency Board** chaired by a presidential appointee and including 12 inspectors general. The Government Accountability Office (GAO) reports on the use of funds by selected states and localities on a bimonthly basis, which are published by the Recovery Accountability and Transparency Board (RATB). The Office of Management and Budget and federal disbursing agencies are also engaged in a rigorous quality review.[13]

To ensure transparency with citizens, e-government tools have played a key role. The government has set up a web site (*www.recovery.gov*) with detailed follow-up on implementation to hold the government accountable for every dollar spent. In addition to the federal government role, the Recovery Act also requires recipients of ARRA grants, contracts and loans to report on the funds they received and spent, the number of jobs

funded by the project and other key metrics. And beyond *www.recovery.gov* itself, the federal agencies disbursing ARRA funds all have dedicated websites that provide a portal for all agency-specific information on programmes, funds and progress. At the state level, state governors play a significant role in overseeing recovery implementation and states have been requested to set up web sites to ensure transparency on the use of recovery funds and involvement from the public.

Incentives to promote public-private co-operation

There are numerous major programmes in the ARRA that are intended to leverage significant funding from the private sector, state and local governments, and other non-federal sources. ARRA programmes built around leverage include loan guarantees designed to bring private capital into clean energy investments, tax credits that match private investment with federal dollars, subsidised bonds that use federal dollars to leverage state and local infrastructure investment and construction programmes in which the federal government co-invests with state, local, and private actors to build low-income housing and other projects (Council of Economic Advisers, 2010a). The Council of Economic Advisers estimates that for every USD 1 the federal government is investing in ARRA projects that involve leverage, other entities are investing about another USD 3, the majority of the additional spending coming from the private sector. As a result, the act is playing a part in investments far beyond the federal spending itself. The largest amount of co-investment is in clean energy, where a federal contribution of USD 46 billion will support more than USD 150 billion in total investments in energy efficiency, renewable generation, research and other areas of the transformation to a clean energy future (Council of Economic Advisors, 2010a).

Implementation of the public investment scheme

Overview of implementation at the federal level…

In October 2010, **71%** of the ARRA funding had been paid out according to the official government website. As of 22 October 22 2010:[14]

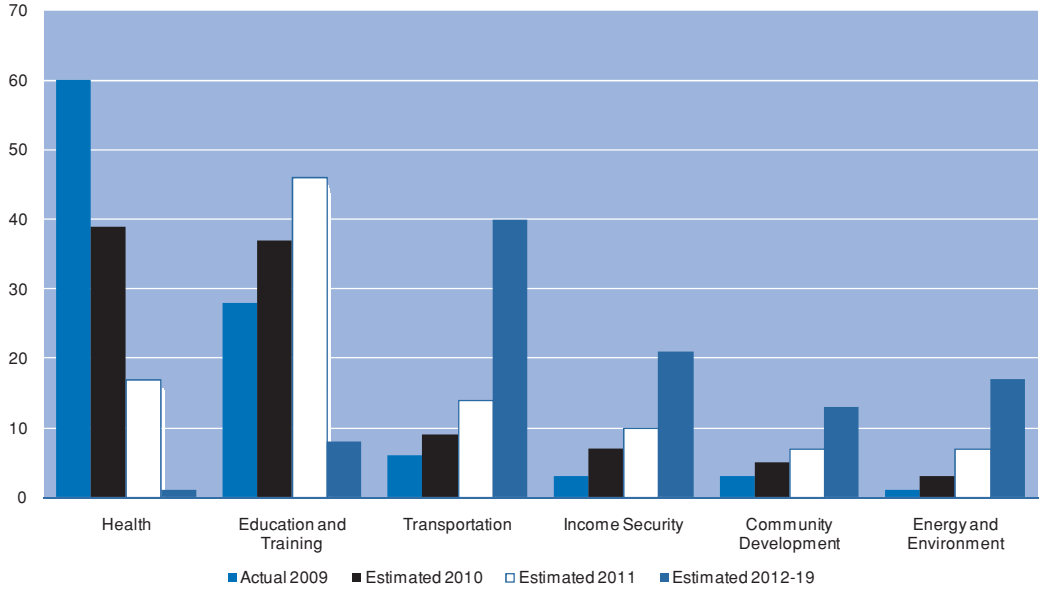
- **55%** of the category "**contracts, grants and loans**" – which mostly finance public investment – had been paid out (i.e. USD 152.1 billion) and almost 80% had been allocated (i.e. USD 219 billion);
- **84.5%** of **tax cuts** (USD 243.4 billion) had been awarded;
- **73%** of **entitlements** (USD 165.7 billion) had been paid out.

…and at the sub-national level

Out of the USD 286 billion administered to states and localities, USD 154 billion, or nearly **55%,** had been paid out by the federal government on 3 September 2010 according to the General Accounting Office (GAO, 2010b). A previous GAO analysis highlights that outlays not only vary in amounts over time but have also shifted by sector. Expenditures in health and education and training constituted 88 % of total outlays to states and localities in fiscal year 2009, while outlays for transport, income security, energy and the environment, and community development were all substantially less (GAO, 2010b). As of July 2010, states had spent about 95% of their Medicaid funding and about 72% of their education funding.

However, it is projected that spending will shift from a primary focus on recovery to a primary focus on investment (GAO, 2010c) (Figure 8.3). For infrastructure spending, about USD 35 billion that the Recovery Act provided for highway infrastructure and public transport for states and municipalities was obligated by the one-year deadline and all states met the deadline (see Figure 8.4 for the allocation of spending in 16 selected states, which receive two-thirds of inter-governmental assistance). Taken together, transport spending – along with investments in the community development, energy and environmental areas – that are geared more toward creating long-term economic growth opportunities will represent approximately two-thirds of state and local Recovery Act funding after 2011 according to the GAO.

Figure 8.3. **Composition of state and local Recovery Act funding, FY2009 and FY2010 through 2019 estimated**



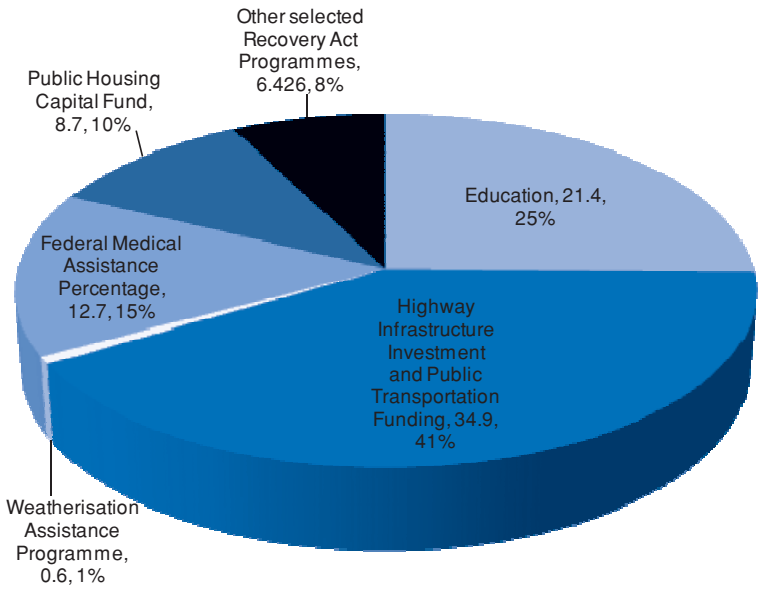
Notes:

1. Each year has a total of 100%. Total in billion is USD 52.9 for 2009; USD 103.7 for 2010; USD 63.7 for 2011 and USD 61.9 for 2012-19.

2. Percentages may not total due to rounding.

Source: GAO (2010), *States and Localities Uses of Funds and Actions Needed to Address Implementation Challenges and Bolster Accountability*, Washington, D.C. Based on analysis of CBO, FFIS and *www.recovery.gov* data.

Figure 8.4. **States' and localities' uses of funds in 16 selected states (which receive two-thirds of the inter-governmental assistance): allocated funding May 2010**



Source: GAO (2010b).

Estimated impact on employment

As a job-creation measure, the US stimulus plan seems to have been successful. Although estimates vary according to economists, there is a relatively broad consensus on the fact that the US fiscal stimulus has contributed to raise aggregate demand and supported employment. Administration estimates suggest that the primary fiscal stimulus package passed in early 2009 has held employment some 2.5 to 3.6 million jobs above what it would have been without the fiscal stimulus (Council of Economic Advisers, 2010b). According to the Congressional Budget Office, the unemployment rate in 2010 will be between 0.7 and 1.8 percentage points lower, as a result of the stimulus package, and the US GDP will be between 1.5% and 4.1% higher (CBO, 2010).

Obstacles and co-ordination challenges across levels of government – lessons learned?

Implementation challenges of ARRA across levels of government have been numerous. They are notably linked to the following types of co-ordination gaps.[15]

Fiscal challenge

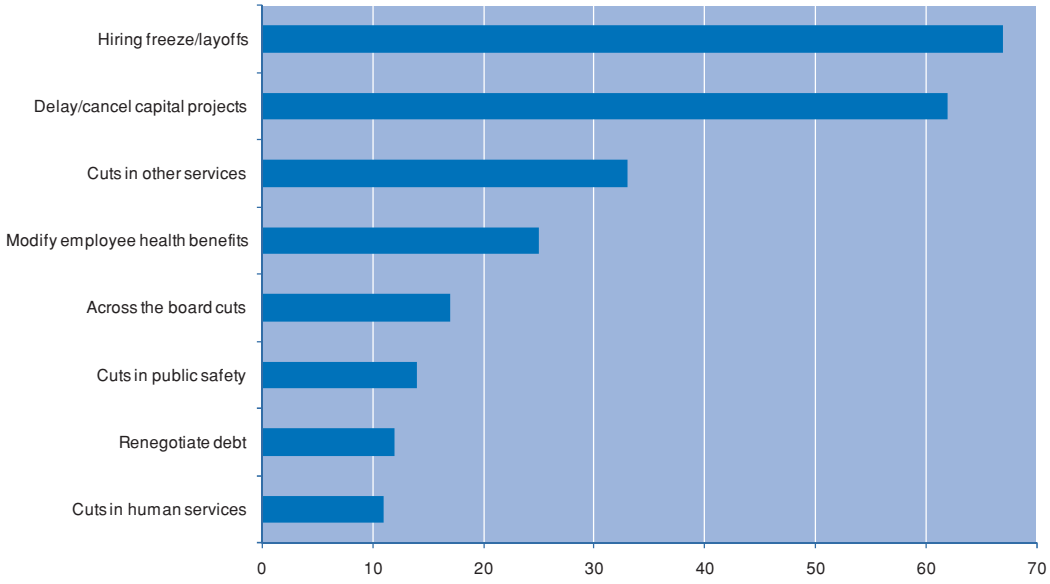
In the United States, 49 states have balanced budget rules enshrined in their constitutions. Any reduction in revenues must therefore be compensated by an equivalent reduction in spending. The crisis has considerably reduced states' revenues, and state budget gaps (i.e. difference between desired spending and projected revenues) have reached unprecedented levels (Bloechliger et al, 2010). Because of balanced budget rules,

sub-national governments had to take measures to balance their 2010 budgets. In addition to raising taxes and increasing fees, these measures focused mostly on spending cuts – across the board cuts, education, hiring and salary freezes, layoffs and early retirement, health care, etc. The states cut expenditures by USD 31.3 billion in 2009 and USD 55.7 billion in 2010. The United States is probably the most notable case of pro-cyclical reactions by sub-national governments.

One of the objectives of the ARRA plan was precisely to stabilise state and local government budgets in order to minimise and avoid reductions in essential services and counter-productive state and local tax increases (*www.recovery.org*). ARRA programmes like SFSF were incredibly important and successfully prevented a bad situation from getting worse.

In this tight fiscal context, challenges to implementing a "**maintenance-of-effort provision**" for infrastructure investment in the context of ARRA at the state level have been "tremendous" according to the General Accounting Office (GAO, 2010c). Despite massive federal support to enhance investment, many states and municipalities have had to cut capital expenditures to balance their budget. The United States is actually the most drastic example of capital spending cuts in the OECD – they have been much sharper than in European countries (OECD, 2010b). Federal funds have provided a certain amount of replacement spending in several states, despite the attempts of the legislation to avoid this. For example, the federal authorities have shown some flexibility on this point for California's transport spending[16] (GAO, 2010c).

Figure 8.5. **US city spending cuts in 2009**



Source: National League of Cities in OECD (2010), "The Impact of Fiscal Consolidation at Sub-National Level: Where do We Stand?", GOV/TDPC/RD(2010)8, OECD, Paris.

Policy challenge: urgency vs. *cross-sectoral co-ordination*

There is an inherent short term *vs.* long term tension in public investment plans launched during the crisis, between using public investment as a demand- and

employment-boosting macroeconomic measure and trying to ensure maximum efficiency of public investment over the long term. During the crisis and recession, the economic and political context call for short-term measures, with the highest impact on employment, which may not necessarily be the most appropriate in a long-term perspective. This challenge is faced by all countries which have used public investment as a key instrument in the recovery. The emphasis on speed in getting funds obligated, although understandable as a goal, has probably overshadowed planning for maximising economic impact. The priority has been the **rapid absorption** of funding, which provides some advantages in terms of the short-term impact of the funding for employment support – the first objective for ARRA – but limits the use of funding for large-scale investment projects for long-term needs, which by nature take longer to design. To meet the one-year deadline for obligating Recovery Act transport funds, states have had to focus on small-scale projects which do not require long design phases.[17] This task has been complicated by the requirement that the stimulus funds not be used as a substitute for funds already allocated to specific projects. The need for speed, plus the non-replacement requirement, has been particularly constraining in the transport sector. Some 63% of the highway funding (i.e. USD 16.2 billion) has been spent on pavement improvement and widening (DOT, 2010).

The ARRA recovery plan has been designed with a strong sectoral dimension along the lines of existing federal programmes (for highways, transit, housing, broadband, energy, etc.), which provides some advantages for rapid implementation. More than 12 federal agencies and departments are responsible for the successful implementation of ARRA programmes (Table 8.A1.1). A key challenge is to enhance co-ordination across programmes and to develop co-ordinated approaches for the use of funding. At the federal level, co-ordination bodies have been established such as the Recovery Implementation Office in the White House, which co-ordinates the implementation of ARRA and reports directly to Vice President Biden. In many states, the vertical approach to investment has remained prevalent, although some initiatives have been taken in some states to foster cross-sectoral co-ordination across programmes (for example in Colorado, New York and Ohio, see Table 8.A1.2).

Given the potential positive and negative spillovers across jurisdictions' investment decisions, inter-state co-ordination is important. There are many non-federal organisations that help co-ordinate among states on these issues, including the National Governors Association, the National Association of Counties, the League of Cities, the Conference of Mayors, the National Association of State Budget Officers and the National Association of State Auditors, Comptrollers and Treasurers.

Capacity challenge

Given the urgency requirements in the use of funding and the rigorous reporting requirements, local governments with an efficient administration which allows them to take immediate action are likely to be the most successful in securing ARRA funding (CGS, 2009). States and governors have had to build or expand capacity for strategic planning and workforce capacity to develop and monitor a rapid growth in contracts. They also have to facilitate local government and private sector opportunities to utilise federal grant and loan programmes to the maximum extent. The challenges for the absorption of funding for SNGs have mainly been linked to the contracting capacity as well as the monitoring one. Some local governments lack the trained manpower needed to carry out intensive contracting processes (NGA, 2010). This, combined with the staff

reductions carried out at the state level, has raised problems for the absorption of funding.[18]

Distressed areas and small municipalities have been less able to apply to relevant programmes and absorb the funding in the relevant timeframe. For example, in a survey carried out in Michigan in 2009[19] in more than 1 300 municipalities, 89% of small municipalities (below 1 500 inhabitants) reported not having received funding through formulas for existing programmes, whereas 64% of large municipalities (above 30 000 inhabitants) reported receiving such funding. For competitive grants programmes, 67% of small municipalities reported not having applied for such grants, whereas only 7% of large municipalities did not apply for these programmes.

Information gap

Although federal agencies have actively communicated around the ARRA programme, as transparency is a founding principle of the act, small municipalities have had more difficulties in gaining access to information. There seems to be a correlation between city size and access to information: for example, the same Michigan survey shows that 51% of municipalities with fewer than 1 500 inhabitants felt badly informed about ARRA opportunities, whereas 74% of municipalities of more than 30 000 inhabitants felt well informed.

The information gap is not only bottom-up, but top-down, linked to the lack of information and data on local needs. For example, economically distressed areas targeted by ARRA have been defined by the Public Works and Economic Development Act of 1965 and may not necessarily correspond well to the areas most affected by the 2008 crisis. According to the GAO, this is also linked to the difficulty in obtaining current data (GAO, 2010c). Hence, some states have developed their own eligibility requirements for economically distressed areas using data or criteria not specified in the Public Works and Economic Development Act (this is the case for example of Arizona, California and Illinois).

Little evaluation is conducted on the long-term impact of ARRA-funded projects, in particular for infrastructure and transport. For infrastructure investment, little analysis is conducted on whether investments produce long-term benefits, since the requirement for performance monitoring is based on inputs (such as number of kilometres of roads or level of expenditures) rather than outcome or long-term objectives. The Recovery Act did not include requirements that the Department of Transportation (DOT) or the states measure the impact of highway and transport investment on economic performance to assess whether these projects ultimately produced long-term benefits[20] (GAO, 2010c). The Department of Transportation is not currently assessing the impact of Recovery Act funds on the transport system but is considering ways to better understand and measure impacts (GAO, 2010c). At the state level, the quality of data collection varies across states, and some states currently measure, collect and track extensive performance metrics based on their individual priorities and definitions.

A few lessons in terms of multi-level governance

The crisis and subsequent recession have highlighted some governance gaps in the United States, in particular the need for enhanced dialogue and policy coherence across levels of government. The US Government has created new dialogue structures, such as the newly named Office of Public Engagement and Intergovernmental Affairs[21] – an

integral part of the executive branch, which aims to increase consultation and co-operation with state and local leaders.

Collaboration, accountability, speed and transparency have been the essential conditions for rapid implementation of the ARRA recovery scheme (DiGiammarino, 2010). The implementation of ARRA has been fast, showing that in times of urgency it is better to rely on existing programmes and investment schemes rather than building new sets of rules from scratch. In the United States, reliance on the existing federal framework for most investment programmes (highways, transit, housing, etc.) has facilitated the understanding of the federal requirements associated with this funding and the monitoring process. The states met the one-year deadline for obligating Recovery Act transport funds in part because state officials are working with a familiar federal framework.

Leadership from the top has proven critical in the implementation of ARRA. In the United States, the Vice President demanded and drove action and held federal agencies and state governors accountable for every Recovery Act dollar they received. The Vice President has held over 15 Recovery Cabinet meetings and conducted 57 conference calls which have collectively included the governors of all 50 states, five representatives from US territories, 119 mayors and 37 county executives. At the state level, each state designated a person in charge of recovery implementation. Several cities also designated a point person to manage recovery. The fact that the Recovery Act was presented as a distinct package made it easier to appoint a single responsible person on the state and agency level.

Collaboration led to new processes being developed to implement the Recovery Act. These processes ranged from large-scale changes within federal agencies to smaller but impactful innovations like the Vice President's 24-hour rule, or Agriculture Secretary Vilsack's review of all Recovery Act awards made by his agency. The Vice President's 24-hour rule is that ARRA teams had to get back to any agency, state, city or other recipients within 24 hours if they had a question or problem concerning the Recovery Act. This contributed to the speed and the accountability of Recovery Act implementation (DiGiammarino, 2010).

The use of technology was also greatly important in contributing to the accountability, speed and transparency of the Recovery Act. Enhanced systems and new processes were created both across government and federal agencies. A new reporting system was set up that requires prime and sub-recipients of recovery contracts, grants or loans to report ten days after quarter close on what progress they have made with the money. Twenty days after they post, the data is reviewed and published on *www.recovery.gov* for anyone to review. Technology has also allowed federal employees to more quickly collaborate to solve problems: allowing them to track more data in better ways to increase accountability, and synthesise and publish that data to meet transparency goals.

The high level of transparency requested in the use of funding has also stimulated new governance approaches to keep citizens informed at each step of the implementation (through government web sites to share information) and strategies to develop input directly from the public as well as local governments and the private sector. A thoughtful planning process that involves multiple stakeholders can help both to identify priorities and the opportunities to co-ordinate a variety of funding sources to help achieve broader goals. In Virginia, for example, the governor has taken a grass-roots approach to planning for the stimulus package and has set up a website seeking input from citizens, local

governments and community groups (see Table 8.A1.2). However, given that planning processes are by nature quite long, relying on pre-existing investment strategies in a crisis context facilitates reactivity.

Looking forward

The implementation of ARRA has highlighted some multi-level governance challenges in the United States that are relevant to address even outside of a crisis context. Although challenges remain important at the state level, particularly in respect of fiscal matters, the crisis and recovery may also be opportunities to further improve the governance of public investment with attempts to complement sectoral approaches by multi-sectoral ones, conditioned by inter-departmental dialogue, with possible merging of different funding sources from the central government. Co-funding mechanisms in a multi-year process could also be discussed as a follow-up to ARRA on a more permanent basis. The proposed new infrastructure plan goes in that direction, as it proposes to set up a government-run infrastructure bank to leverage federal money with state, local and private sector investments to finance projects and better prioritise investment projects.

The issues arising from the lack of a strategic territorial approach to investment prior to the crisis may have contributed to a renewed focus on regional policy in the recovery context. An increased co-ordination process at federal level for regional development policy is notable. In August 2009, the Obama administration also released a "Memorandum for the Heads of Executive Departments and Agencies", framing the new US approach to place-based policies. The intent is to create a more effective, multi-level governance framework, to influence how rural and metropolitan regions develop through streamlining otherwise redundant and disconnected programmes, and to identify principles for regional policy that are clear and measurable.

As a result, integrated approaches to regional policy have begun to surface across the federal government. One example of this renewed focus is the attention granted to clusters. Specifically, USD 300 million has been requested for regional innovation clusters in the FY2011 budget. The National Economic Council is co-ordinating these efforts, which will involve six agencies: the Departments of Commerce, Education, Energy, Labor, the National Science Foundation and the National Institute of Standards and Technology. Ultimately, these federal agencies will seek bids from regional economies around the country, which will require a "bottom up" self-organising effort by states and localities, universities and federal research labs, workforce development agencies and the private sector. Another example is the *Livable Communities Initiative*, a new inter-departmental approach to regional policy, which has been introduced in the US Congress. This legislation and interim administrative actions will support regional efforts at the Departments of Housing and Urban Development, Commerce, Transportation, Environmental Protection, and the United States Department of Agriculture.

Notes

1. Notably through the Troubled Asset Relief Program (TARP).
2. The Recovery Act appropriated USD 8.4 billion to fund public transit throughout the country through existing Federal Transit Administration (FTA) grant programmes.
3. USD 48.6 billion to award to states for education by formula and up to USD 5 billion to award to states as competitive grants.
4. According to the *OECD Economic Survey of the United States*, to achieve the goal of reducing the federal deficit to 3% in 2015, spending restraint is unlikely to suffice, so taxes will also have to increase (OECD, 2010).
5. This would include in particular an extension of the R&D tax credit (USD 100 billion). Other tax cuts for multi-national companies, oil and natural gas companies would on the other hand be suppressed (Financial Times, 2010).
6. Additionally, many of the competitive grant programmes did not go directly to state or local governments, but rather to entities such as non-profit organisations, private businesses or consortia.
7. These mechanisms are particularly important in the Highways Program and education programmes, among others.
8. The way in which the maintenance-of-effort provision has been defined (i.e. level of investment planned the day of enactment of the ARRA Act) has been criticised as some officials suggested an averaging of prior expenditures and commitments would be more workable than a point-in-time estimate, although this might also commit states to spending levels that were established when the economy was stronger.
9. Unless other timelines are established in the legislation for a specific programme (for the Education Program for instance), the timeline is 30 September 2011.
10. It is just the tail of the actual spending path that will stretch into future years; more than 70% of the total ARRA has either been outlaid or already been claimed as tax reductions.
11. *www.recovery.gov.*
12. To qualify as an economically distressed area, an area must: *i)* have a per capita income of 80% or less of the national average; *ii)* have an unemployment rate that is, for the most recent 24-month period for which data are available, at least 1% greater than the national average unemployment rate; or *iii)* be an area that the Secretary of Commerce determines has experienced or is about to experience a "special need" arising from actual or threatened severe unemployment or economic adjustment problems resulting from severe short- or long-term changes in economic conditions.
13. *www.recovery.gov/FAQ/Pages/FundsAwardedExplanation.aspx.*
14. *www.recovery.gov*.

15. The terminology "gap" refers to the OECD (2009) analytical framework on multi-level governance.

16. Projects already launched with state bond monies risked being cut off when the state's budget woes caused it to stop issuing bonds in December 2008. The state is using stimulus funds to continue some of these projects, and it will use future bond sale receipts to pay for stimulus-funded projects.

17. This characterisation does not apply to certain programmes that were intentionally designed to spend out more slowly and have a longer term impact, such as high-speed rail.

18. For example, Officials at the Iowa Department of Education expressed concern that recent staff reductions at the state level and a steady loss of experienced business managers in many LEAs across the state could result in less oversight of funds.

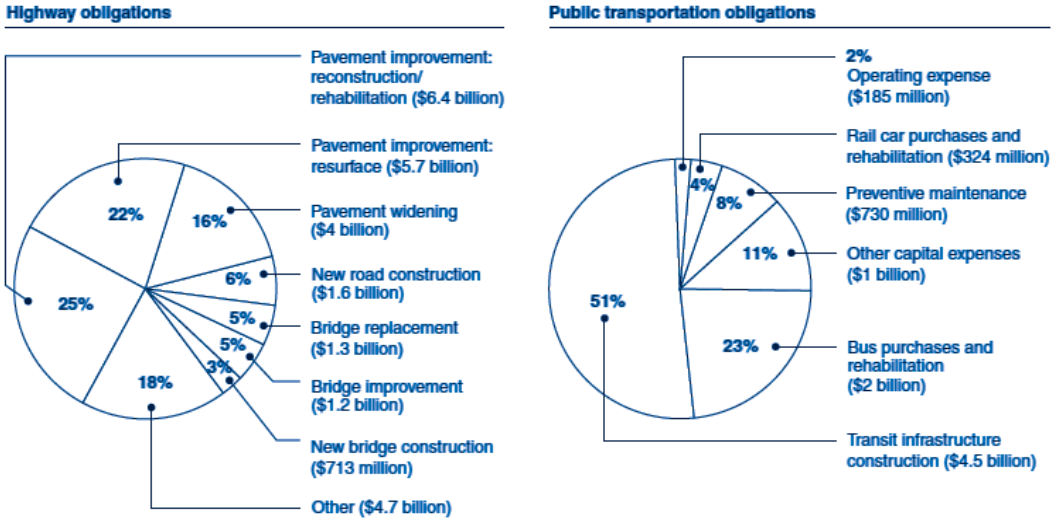
19. The Michigan Public PolicySurvey is a biannual survey of each of Michigan's 1 856 units of general purpose local government. A total of 1 204 jurisdictions in the spring 2009 wave and 1 303 jurisdictions in the fall 2009 wave returned valid surveys (Center for Local, State and Urban Policy, 2010).

20. This is the long-standing practice of the federal government with regard to highway spending; states have historically been given significant discretion in their use of highway funds.

21. The White House Office of Intergovernmental Affairs works closely with state, tribal and local officials to ensure effective government co-ordination. State, tribal and local governments are critical to the creation and implementation of national policy; thus, maintaining a strong partnership is the best way to provide strong leadership and bring change to US citizens. See *www.whitehouse.gov/administration/eop/iga*.

Annex 8.A1

Figure 8.A1.1. **ARRA highway and public transport obligations by project type**



Source: GAO (2010) analysis of DOT (2010) data.

Table 8.A1.1. Selected grant programmes and their administering federal agency or office

Federal agency	Agency office	Grant programme of programmes administered
Department of Agriculture	Food and Nutrition Service	Supplemental Nutrition Assistance Program
	Forest Service	Wildland Fire Management Program
Department of Commerce	National Telecommunications and Information Administration	Broadband Technology Opportunities Program/ State Broadband Data and Development Program
Department of Education	Office of Elementary and Secondary Education	Elementary and Secondary Education Act Title I-A grants
		State Fiscal Stablization Fund
	Office of Special Education and Rehabilitative Services	Individuals with Disability Education Act Part B and C grants
Department of Energy	Office of Energy Efficiency and Renewable Energy	Clean Cities Program Energy efficiency and conservation block grants Weatherization Assistance Program
Department of Health and Human Services	Administration for Children and Families	Childcare and development block grant Community services block grants Head Start/Early Start Recovery Act impact on child support incentives Titla IV-E adoption assistance and foster care programs
	Centres for Medicare and Medicaid Services	Medicaid Federal medical assistance percentage
	Health Resources and Services Administration	Capital Improvement Program Increased demand for services
Department of Homeland Security	Federal Emergency Management Agency	Emergency Food and Shelter Program Recovery Act assistance to firefighters fire station construction grants
Department of Housing and Urban Development	Office of Community Planning and Development	Community development block grants Homelessness Prevention and Rapid Re-housing Program Neighborhood Stabilization Program II
	Office of Public and Indian Housing	Public Housing Capital Fund
Department of Justice	Office of Community Oriented Policing Services	Community Oriented Policing Services Hiring Recovery Program
	Office of Justice Programs	Assistance to Rural Law Enforcement to Combat Crime and Drugs Program Edward Byrne Memorial Justice Assistance Grant Program Internet crimes against children initiatives
	Office of Violence Against Women	Services training officers prosecutors violence against women formula grants
Department of Labor	Employment and Training Administration	Senior Community Service Employment Program Workforce Investment Act Title I-B grants

Table 8.A1.1. Selected grant programmes and their administering federal agency or office *(cont'd)*

Federal agency	Agency office	Grant programme of programmes administered
Department of Transportation	Federal Aviation Administration	Airport Improvement Program
	Federal Highway Administration	Federal Aid Highway Surface Transportation Program
	Federal Transit Administration	Fixed Guideway Infrastructure Investment Program Transit Capital Assistance Program Transit Investments for Greenhouse Gas and Energy Reduction Grant Program
	Office of the Secretary	Transportation investment generating economic recovery discretionary grants
Environmental Protection Agency	Office of Air and Radiation	Diesel Emission Reduction Act grants
	Office of Solid Waste and Emergency Response	Brownfields Program
	Office of Water	Clean Water State Revolving Fund Drinking Water State Revolving Fund
National Endowment for the Arts		National Endowment for the Arts Recovery Act grants

Source: GAO (2010).

Table 8.A1.2. New types of governance arrangements for the implementation of ARRA at the state level

New types of governance arrangements	Examples
Cross-sectoral co-ordination for the design	– Colorado: 11 transportation commissioners determine which projects to fund based in part by recommendations for local governments and planners. – Connecticut: a working group was created of municipal officials, business leaders, legislators and state agencies to determine the final list of stimulus projects. – Kansas: Governor Sebelius has assembled a group of key state officials, including four representatives appointed by state legislative leaders, to better prepare Kansas for the use of new federal funds. – Kentucky: the governor has created an inter-agency workgroup with representatives from state Cabinets and agencies to advise on implementation of the stimulus. – New Jersey: the governor has formed a federal stimulus working group to spearhead New Jersey's efforts in maximising federal economic stimulus aid and a second group to monitor job creation resulting from his Economic Assistance and Recovery Plan. – New York: Governor Paterson has created the New York State Economic Recovery and Reinvestment Cabinet to manage the development and state and local infrastructure projects financed through the ARRA. The cabinet will oversee the distribution of federal funds throughout the state for projects involving transport, water and sewer, energy, technology and other infrastructure. It will work closely with local governments to ensure federal dollars reach critical projects and put people to work as quickly as possible. – Ohio: a cross-agency team is working together to administer all federal stimulus activities.
Implementation and monitoring	– California: every agency is part of a working group to constantly monitor the implementation of the stimulus. – Michigan: Governor Granholm has established the Michigan Economic Recovery Office to co-ordinate the implementation of the recovery programme. Advising the office are five working groups: infrastructure, schools, IT and broadband, buildings and greening.
Lead co-ordinator or task force for monitoring the implementation	– Iowa: the governor has convened a working group consisting of the state agencies that will oversee the implementation and maximisation of recovery funds. – Oklahoma: the governor has assigned Cabinet officials to analyse the operational, financial, legal and management responsibilities of the stimulus package. They are working with technical teams in all areas of state government to examine the potential for strategic partnerships, to develop accountabilities, review processes and ensure reporting requirements are met.
Evaluating the impact	The Massachusetts DOT recently developed an Office for Performance Management that will eventually focus on measuring the impact of the state's entire portfolio of infrastructure investment, but the office is in its early stages of development and it is uncertain as to when the office will be able to produce results.
Inputs from the public and private sector	– Maine: guidance and inputs from lawmakers (provide legislative leaders with an opportunity to review a plan for spending the stimulus). – Oregon: the governor created a new public-private advisory council called the Oregon Way Advisory Group to use Oregon's green advantage to maximise potential grants from the federal economic recovery package to create jobs immediately and for the long term.
Keep citizens well informed	Most states have developed web sites on follow-up of the use of funding.
Facilitate application from private actors	Ohio: those interested in applying for stimulus funds submit a one-page form on the web site which is then forwarded to Ohio agencies and staff for review and next steps.

Source: NGA web site (2010).

Table 8.A1.3. Allocation of funds analysis for the 16 states covered by GAO (two-thirds of funding to SNGs)

Programme/policy	Amount allocated and criteria for allocation	Key priorities in spending	Amount implemented as of 1 November 2010
Federal Medical Assistance Percentage (FMAP)Medicaid	USD 58.93 billion awarded.		As of 31 July 2010, the 16 states and the District of Colombia had drawn down USD 43.9 billion in increased FMAP funds, which is 75% of the total USD 58.9 billion in increased FMAP that we estimated would be allocated to these states and the District through 31 December 2010.[1] The national drawdown mirrors the experiences of our sample states, with the 50 states and the District having drawn down 74% of their estimated total allocation of nearly USD 87 billion through the end of 2010.
Education	USD 48.6 billion to award to states by formula and up to USD 5 billion to award to states as competitive grants.	The Recovery Act created the SFSF in part to help state and local governments stabilise their budgets by minimising budgetary cuts in education and other essential government services, such as public safety. Stabilisation funds for education distributed under the Recovery Act must first be used to alleviate shortfalls in state support for education to local education agencies (LEA) and public institutions of higher education (IHE). The application required each state to provide several assurances, including that the state will meet maintenance-of-effort requirements (or will be able to comply with the relevant waiver provisions) and that it will implement strategies to advance four core areas of education reform.[2]	As of 27 August 2010, the District and states covered in GAO's review had drawn down 72% (USD 18.2 billion) of their awarded State Fiscal Stabilization Fund (SFSF) education stabilisation funds; 46% (USD 3.0 billion) for Elementary and Secondary Education Act, Title I, Part A; and 45% (USD 3.4 billion) for Individuals with Disabilities Education Act, Part B. In the spring of 2010, GAO surveyed a nationally representative sample of local educational agencies (LEA) and found that job retention was the primary use of education Recovery Act funds in school year 2009-10, with an estimated 87% of LEAs reporting that Recovery Act funds allowed them to retain or create jobs.

Table 8.A1.3. Allocation of funds analysis for the 16 states covered by GAO (two-thirds of funding to SNGs) *(cont'd)*

Programme/policy	Amount allocated and criteria for allocation	Key priorities in spending	Amount implemented as of 1 November 2010
Highway Infrastructure Programme	States are required to ensure that all apportioned Recovery Act funds – including sub-allocated funds – are obligated within one year. The Secretary of Transportation is to withdraw and redistribute to eligible states any amount that is not obligated within these time frames. Additionally, the governor of each state must certify that the state will maintain its level of spending for the types of transport projects funded by the Recovery Act it planned to spend the day the Recovery Act was enacted.[3]	The Recovery Act requires that 30% of these funds be sub-allocated, primarily based on population, for metropolitan, regional and local use. Highway funds are apportioned to states through federal-aid highway programme mechanisms, and states must follow existing programme requirements. While the maximum federal fund share of highway infrastructure investment projects under the existing federal-aid highway programme is generally 80%, under the Recovery Act, it is 100%.	States and transit agencies continue to use Recovery Act funding to improve the conditions of the transport system. Nationwide, about half (or over USD 12 billion) of the highway infrastructure Recovery Act funds were obligated primarily for pavement improvement reconstruction, rehabilitation, and resurfacing. About USD 35 billion that the Recovery Act provided for highway infrastructure and public transport was obligated by the one-year deadline; therefore, no Recovery Act funds were withdrawn for redistribution. The Federal Highway Administration (FHWA) obligated about USD 26.2 billion of the USD 26.7 billion that was apportioned to all 50 states and the District of Columbia for over 12 000 highway infrastructure and other eligible projects nationwide. In addition, by the 2 March 2010, deadline, about USD 420 million of the apportioned amount that was not obligated to highway projects was transferred from FHWA to the Federal Transit Administration (FTA) to be obligated for transit projects.65 FTA obligated all of the approximately USD 8.4 billion that was apportioned to fund public transport projects as well as all but USD 78 million of the about USD 420 million transferred from FHWA to FTA. FTA awarded these funds to about 1 000 grants nationwide by the 5 March 2010, deadline.66 The United States Department of Transportation (DOT) has determined that once Recovery Act highway funds are transferred to FTA, these funds are not subject to the Recovery Act's one-year obligation deadline for either FHWA or FTA because they are subject to the provisions of the law that apply generally to the transfer of highway funds to FTA.

Table 8.A1.3. Allocation of funds analysis for the 16 states covered by GAO (two-thirds of funding to SNGs) *(cont'd)*

Programme/policy	Amount allocated and criteria for allocation	Key priorities in spending	Amount implemented as of 1 November 2010
Public Transit Program	The Recovery Act appropriated USD 8.4 billion to fund public transit throughout the country through existing Federal Transit Administration (FTA) grant programmes, including the Transit Capital Assistance Program, and the Fixed Guideway Infrastructure Investment Program.	Under the Transit Capital Assistance Program's formula grant programme, Recovery Act funds were apportioned to large and medium urbanised areas – which in some cases include a metropolitan area that spans multiple states – throughout the country according to existing programme formulas. Recovery Act funds were also apportioned to states for small urbanised areas and non-urbanised areas under the Transit Capital Assistance Program's formula grant programmes using the programme's existing formula. Transit Capital Assistance Program funds may be used for such activities as vehicle replacements, facilities renovation or construction, preventive maintenance, and paratransit services. Recovery Act funds from the Fixed Guideway Infrastructure Investment Program were apportioned by formula directly to qualifying urbanised areas, and funds may be used for any capital projects to maintain, modernise or improve fixed guideway systems. As they work through the state and regional transport planning process, designated recipients of the apportioned funds – typically public transit agencies and metropolitan planning organisations (MPO) – develop a list of transit projects that project sponsors (typically transit agencies) submit to FTA for approval[4]	About half of the public transport funds (or over USD 4 billion) has been obligated for transit infrastructure construction, such as upgrading power substations or enhancing bus shelters.
Weatherization Assistance Program	The Recovery Act provides USD 5 billion for weatherisation funding nationwide.		According to DOE officials, as of 15 November 2010, about 240 000 homes have been weatherised nationwide, out of approximately 570 000 homes currently planned for weatherisation.
Broadband Technology Opportunities Program/State Broadband Data and Development Program	The Department of Commerce's National Telecommunications and Information Administration (NTIA) administers the Recovery Act's Broadband Technology Opportunities Program. This programme was appropriated USD 4.7 billion, including USD 350 million for the purposes of developing and maintaining a broadband inventory map.	NTIA has developed the State Broadband Data and Development Grant Program, a competitive, merit-based matching grant programme to fund projects that collect comprehensive and accurate state-level broadband mapping data, develop state-level broadband maps, aid in the development and maintenance of a national broadband map, and fund state-wide initiatives directed at broadband planning.	

Table 8.A1.3. Allocation of funds analysis for the 16 states covered by GAO (two-thirds of funding to SNGs) *(cont'd)*

Programme/policy	Amount allocated and criteria for allocation	Key priorities in spending	Amount implemented as of 1 November 2010
Transportation Investment Generating Economic Recovery Discretionary Grants	Administered by the Department of Transportation's Office of the Secretary, the Recovery Act provides USD 1.5 billion in competitive grants, generally between USD 20 million and USD 300 million, to state and local governments, and transit agencies.	These grants are for capital investments in surface transport infrastructure projects that will have a significant impact on the nation, a metropolitan area or a region. Projects eligible for funding provided under this programme include, but are not limited to, highway or bridge projects, public transport projects, passenger and freight rail transport projects, and port infrastructure investments.	
Clean Water and Drinking Water State Revolving Funds	Clean Water and Drinking Water State Revolving Funds: the Recovery Act appropriated USD 4 billion for the Environmental Protection Agency's (EPA) Clean Water State Revolving Fund (SRF) and USD 2 billion for the Drinking Water SRF. Nationwide, these funds are being used to support over 3 000 projects.	Although EPA and states have expanded their oversight, current procedures, such as site inspections, may not be adequate. GAO recommends that EPA work with the states to implement specific oversight procedures to monitor and ensure sub-recipients' compliance with Recovery Act provisions.	

Notes: 1. See GAO (2009), *Estimated Temporary Medicaid Funding Allocations Related to Section 5001 of the American Recovery and Reinvestment Act,* GAO-09-364R, Washington, D.C., 4 February 2009. The Recovery Act provided states and the District of Colombia with an estimated USD 87 billion in increased FMAP funds for Medicaid from February 2009 through December 2010. Our estimate was based on funds drawn down by states as of 30 June 30 2010.

2. *i)* Increase teacher effectiveness and address inequities in the distribution of highly qualified teachers; *ii)* establish a pre-K through college data system to track student progress and foster improvement; *iii)* make progress toward rigorous college- and career-ready standards and high-quality assessments that are valid and reliable for all students, including students with limited English proficiency and students with disabilities; and *iv)* provide targeted, intensive support and effective interventions to turn around schools identified for corrective action or restructuring. In addition, states were required to make assurances concerning accountability, transparency, reporting and compliance with certain federal laws and regulations. After maintaining state support for education at fiscal year 2006 levels, states must use education stabilisation funds to restore state funding to the greater of fiscal year 2008 or 2009 levels for state support to LEAs and public IHEs. When distributing these funds to LEAs, states must use their primary education funding formula, but they can determine how to allocate funds to public IHEs. In general, LEAs have broad discretion in how they can use education stabilisation funds, but states have some ability to direct IHEs in how to use these funds.

3. As part of this certification, the governor of each state is required to identify the amount of funds the state plans to expend from state sources from 17 February 2009 through 30 September 2010.

4. Metropolitan planning organisations (MPO) are federally mandated regional organisations representing local governments and working in co-ordination with state departments of transport, that are responsible for comprehensive transport planning and programming in urbanised areas. MPOs facilitate decision making on regional transport issues, including major capital investment projects and priorities. To be eligible for Recovery Act funding, projects must be included in the region's Transportation Improvement and State Transportation Improvement Programs.

Source: GAO (2010), "States and Localities Uses of Funds and Actions Needed to Address Implementation Challenges and Bolster Accountability", GAO, Washington, D.C.; GAO (2010), "Opportunities to Improve Management and Strengthen Accountability Over States' and Localities' Use of Funds", GAO-10-999, GAO, Washington, D.C., September.

Table 8.A1.4. Examples of municipal fiscal distress in the United States

City (state)	Budget shortfalls
Augusta (Maine)	Mid-year budget shortfall and decreasing budget for next fiscal year, resulting in layoffs, reductions in police and fire overtime and reductions in services.
Baltimore (Maryland)	USD 127 million shortfall, likely resulting in a next round of layoffs and furloughs after having already eliminated more than 500 positions.
Bossier City (Louisiana)	USD 6.5 million deficit in the city's current USD 50.3 million budget, resulting in the proposed elimination of 117 out of 897 positions, including 80 police and fire positions.
Boston (Massachusetts)	USD 130 million shortfall, resulting in layoffs of more than 500 municipal employees.
Cleveland (Ohio)	USD 23 million shortfall, and the city estimates that for every USD 1 million about 20 general city employees or 12 police and firefighters would have to be laid off.
Columbia (Missouri)	USD 4 million budget shortfall in 2009-10, covered through cutbacks in personnel and programmes.
Dallas (Texas)	USD 190 million budget shortfall; 637 full-time positions to be eliminated, including 347 layoffs and cuts to street repairs, libraries and senior services.
Denver (Colorado)	USD 120 million shortfall, resulting in layoffs of 80 positions and early retirement of 322 city workers.
Dover (Delaware)	Budget decrease of USD 10.5 million from in 2009, covered by requiring all city employees to take 12 unpaid furlough days and the deferral of capital improvements.
East Providence (Rhode Island)	Reduced city positions by 55, including 16 in the police department and 28 in the fire department.
Little Rock (Arkansas)	USD 2.8 million shortfall, resulting in USD 200 000 cut in police services and USD 450 000 cut in fire services.
Los Angeles (California)	USD 98 million shortfall in 2009-10, USD 408 million in 2010-11, and predicting total shortfall near USD 1 billion by 2013; the city has already removed 2 400 positions from the city payroll through early retirement, furloughs and other workforce reductions.
Sacramento (California)	General fund revenues declined by USD 15 million, resulting in eliminating funding for 387 positions.
San Francisco (California)	USD 436 million shortfall and expecting USD 80-100 million more due to declining revenue collection and state cuts; mayor asked city departments for 25% cuts.
Seattle (Washington)	USD 72 million budget shortfall, resulting in the elimination of 310 positions and the city using USD 25.4 million of a USD 30.6 million Fiscal Stabilization ("rainy day") Fund.
Springfield (Illinois)	USD 8.5 to USD 12 million shortfall in next fiscal year, which would mean eliminating 136 to 192 positions.
Springfield (Missouri)	USD 13.7 million in budget cuts, resulting in four positions eliminated and furloughs of 158 employees.

Source: Based on Hoene (2009) in OECD (2010), "The Impact of Fiscal Consolidation at Sub-National Level: Where Do We Stand?", GOV/TDPC/RD(2010)8, OECD, Paris.

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