# 27

# Public Investment Management and Public-Private Partnerships

*Jim Brumby, Kai Kaiser and Jay-Hyung Kim*

While there is consensus around the centrality of public investment to growth and social welfare, there remain for many developing countries concerns about the inefficiency of public investment projects, the inability of governments to create value-for-money assets, the lack of clear champions to push forward an agenda to improve public investment management, and the complexities of managing the involvement of the private sector in public investment, especially through public-private partnerships (PPPs). The management of public investment, like all public resource allocation through public financial management (PFM) systems, can be viewed through the lens of the commonly agreed level one, two and three objectives of PFM, namely aggregate fiscal management and control, efficiency in the allocation of resources, and technical efficiency.

In common with other fiscal interventions, public investment projects need to be affordable and consistent with prudent management of the fiscal entity undertaking them. This suggests that the size of the envelope for government funded projects needs to be considered within the context of all competing programs and projects, and all available funding. So while public investment constitutes a special form of spending, in that it creates assets which provide service potential for many years, it still needs to pass the same test of providing positive returns that all spending should face. Moreover, even if good quality projects are chosen, they need to be implemented in a cost-effective manner; otherwise positive returns will be lost.

PPPs, which are discussed at some length later in the chapter, can also be viewed through the lens of the three PFM objectives. Much of the initial interest in PPPs was driven by a desire to escape the straightjacket of the available fiscal envelope (as captured, for instance, by the public sector borrowing requirement). The private sector was seen as a source of additional funding, with the result that large or mega projects that would not have been affordable under traditional budget funding were given a green light thanks to this new funding source. As time passed, PPPs have also been seen as a way to escape some of the inefficiencies associated with standard government spending and operational management. With stronger incentives for efficient operation, it was thought that private operators would build better assets faster and for less, and operate them at lower cost.



R. Allen et al. (eds.), *The International Handbook of Public Financial Management*
© Palgrave Macmillan, a division of Macmillan Publishers Limited 2013

Accordingly, an evaluation of PPPs requires the teasing out of evidence about cost savings and efficiency gains in asset creation and service delivery, and about the contribution of PPPs to the national economy.

The objective of this chapter is to highlight the diverse institutional underpinnings shaping the quality of public investment and to make a case for strengthening public investment management (PIM), especially in the case of PPPs where efforts to reap their potential benefits carry some not inconsiderable risks.

## Public investment management

Converting expenditure into real economic and social gains appears challenging with public investment. Some estimates suggest that a typical unit of public investment spending in developing countries translates into only half a unit of value from the corresponding physical assets.[1] Such a low payoff provides support for ongoing concerns about the ability to address the massive infrastructure gaps that exist worldwide, especially in developing countries (Foster and Briceño-Garmendia 2010). Whereas aggregate levels of government spending have typically been at the center of fiscal policy analysis and discussion, there is increasing empirical and policy focus on the particular challenges and options for improving the management of different modalities of public investment. There are specific challenges associated not only with PPPs (Schwartz and others. 2008) and mega projects (Flyvbjerg and others 2003), but also with the role and performance of state-owned enterprises and subnational governments in providing public infrastructure.

As with many types of government intervention, the effects of public investment can be hard to measure. For instance, there are considerable difficulties in accurately measuring the stock of public fixed capital, along with additions to and subtractions form the stock. For instance, poor initial asset quality and unsatisfactory operations and maintenance practices can reduce the service life of the public capital stock due to premature degradation (e.g., roads washing away in the rainy season) and also diminish the flow of services generated by the asset (e.g., schools without books or hospitals without medical equipment) for the period they are in service. In many countries, timely and accurate information on the size, composition, quality and use of public assets is simply not available.

Anecdotal evidence also suggests that there are large-scale inefficiencies in public investment due to leakages which suck funds away from their intended purposes. Poor countries with weak institutions and high levels of corruption are especially vulnerable in this regard. One strand of the empirical public finance literature suggests that while weak institutions may skew public spending towards public investment, including infrastructure, the sectors that benefit may be especially prone to rent seeking. Tanzi and Davoodi (1997) find that elevated levels of corruption are associated with high public investment, low operations and

[1] This finding is based upon calculation of estimates of efficiency-adjusted public capital stocks by Gupta and others (2011, p. 10, table 2), which utilize an international PIM index (Dabla-Norris and other 2011).