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Creating Conditions
for Effective Public
Investment: Sub-national
Capacities in a Multi-level
Governance Context

**Lee Mizell,
Dorothee Allain-Dupré**

<https://dx.doi.org/10.1787/5k49j2cgv5mq-en>

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CREATING CONDITIONS FOR EFFECTIVE PUBLIC INVESTMENT: SUB-NATIONAL CAPACITIES IN A MULTI-LEVEL GOVERNANCE CONTEXT

Lee Mizell and Dorothée Allain-Dupré¹

Growth and jobs are top concerns for policy makers confronting difficult economic conditions in many OECD countries. Sub-national governments are important contributors to national growth, but in many cases their economies are struggling as well. Faced with tight fiscal conditions, all levels of government must achieve policy goals with fewer resources. This is particularly true for public investment, a potentially growth-enhancing form of public expenditure which numerous governments are reducing to meet other (current) financial obligations. Even where public investment is stable or increasing, governments may want to improve returns to public and private investment.

On average, nearly two-thirds of public investment in OECD countries occurs at the sub-national level. Clearly then, any discussion of improving returns to investment must address the capacities of sub-national governments to invest effectively. Unfortunately, the implementation of recovery packages across OECD countries revealed that both national and sub-national actors may lack the appropriate tools and governance arrangements to make the best use of investment funds. Taking this finding as its starting point, this paper seeks to 1) identify capacities that enable sub-national governments to design and implement sound public investment strategies for regional development, and 2) provide practical guidance for assessing and strengthening these capacities in a context of multi-level governance.

JEL Classification: H1, H5, H7, R1, R5

Keywords: multi-level governance, decentralisation, public investment, sub-national government, capacity, regional development

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ACKNOWLEDGEMENTS

This paper has been a collaborative effort and the authors wish to extend their appreciation to numerous colleagues. Sincere thanks to Alex Matheson, whose contributions over many months helped to shape the paper in important ways. William Tompson provided thoughtful inputs and reviewed the document on numerous occasions. The paper benefitted significantly from suggestions and contributions provided by Rudiger Ahrend, Lorenzo Allio, Elodie Beth, Claire Charbit, Catherine Gamper, Claudia Hulbert, Karen Maguire, Adam Ostry, Delia Rodrigo, and Camila Vammalle. Hanna Kleider contributed analysis using the Regional Authority Index. Thai Thanh Dang summarised data from the regional and national questionnaires.

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Introduction

Growth and jobs: the perennial goals for policymakers are more urgent than ever. Numerous countries in the OECD area continue to struggle with fiscal constraints, low growth, and stubbornly high unemployment rates. Sub-national regions are important contributors to national growth, but their economies are struggling as well. Public investment, if well managed, represents a potentially important growth-enhancing form of public expenditure. However, in the current tight fiscal climate it is often reduced to meet current spending obligations. Better governance has become a priority for making better use of scarcer fiscal resources. But how should countries and regions better manage and finance public investment strategies? What improvements can be made over past practices? One answer lies in recent research: the implementation of recovery packages across OECD countries revealed that both national and sub-national actors may lack the appropriate tools and governance arrangements to make the best use of investment funds (Allain-Dupré, 2011; OECD, 2011a).

Taking this finding as its starting point, this paper is concerned with 1) identifying important capacities that enable sub-national governments (SNGs) to design and implement sound public investment strategies for regional development, and 2) providing practical guidance for assessing and strengthening these capacities. To do so, the paper draws on multiple sources of information: a review of relevant literature, findings emerging from case studies of five OECD regions, material presented at two OECD expert workshops and responses to two surveys regarding public investment – one targeting national governments and another for regions.¹

It is worth noting that both “public investment” and “capacity” can be fuzzy concepts, the latter more so than the former. Here, the focus is on public investment for regional development. For this reason, “public investment” for the purposes of this paper refers to expenditures to finance physical infrastructure (e.g. roads, rail, ports, government buildings) and soft infrastructure (e.g. human capital development, innovation, research and development) whose productive life extends beyond the fiscal year. These are largely – but not exclusively – capital expenditures. The term “capacity” can be a catch-all for a myriad of policies, institutional arrangements, and professional competences – only some of which play a central role in effective public investment for regional economic development. Hall (2008: 110) notes that “capacity is unique to the object being studied, so it should be defined as the capacity to do something specific.” Here it refers to the ability to adhere to good practices in the design and implementation of public investment as defined above. More specifically, it refers to good practices in terms of the institutional arrangements, technical capabilities, financial resources, and policy practices that can help sub-national governments achieve important goals at different stages of the investment cycle.

The focus of this paper is sub-national governments, with a strong orientation to regions. Regions refer to the level immediately below the central government. For federal or regionalised countries, these are likely to be self-governing entities, defined as a “region”, “state”, “province” or “Länder”, depending on the country. Administrative regions may exist in unitary countries largely for the purposes of planning and delivering services. While they often have

1. The OECD national questionnaire on multi-level governance of public investment was circulated to 31 member states in February 2012. This paper is based on the 20 responses received as of July 2012. They are: Australia, Belgium, Canada, Chile, Czech Republic, Estonia, France, Germany, Hungary, Italy, Mexico, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom. The OECD regional questionnaire on sub-national public investment was distributed to six case study regions in early 2012, plus one additional region – resulting in a total of 7 completed surveys. The six case study regions are: Skåne (Sweden), Galicia (Spain), Wielkopolska (Poland), Brandenburg (Germany), British Columbia (Canada) and Victoria (Australia). Additional survey data come from the canton of Vaud, Switzerland.

limited authority, they may nonetheless be important for public investment. Sub-national government also includes municipal (local) authorities.

Finally and critically, sub-national capacities are examined in a multi-level governance context. Although the focus here is on the capacities that sub-national governments should possess to undertake public investment effectively, the paper is grounded in the acknowledgement that public investment is a shared responsibility among levels of government - with actors at all levels playing (what should be) complementary roles.

Main messages

This paper provides an analytic framework for evaluating capacities for public investment and an indication of weaknesses and good practices observed in OECD countries. The main messages which emerge are:

- **Institutional quality matters for public investment.** Not only does literature suggest that governance matters for public investment at the national level (Dabla-Norris et al., 2011, Rajaram et al. 2010), but at the regional level there is also likely to be better implementation of and greater returns to public investment in the presence of sound institutional quality, particularly for substantially lagging regions (Rodríguez-Pose, 2012; Milio, 2007) The OECD found weaknesses in sub-national governance were among the factors that hindered the implementation of stimulus packages in the wake of the 2008 financial crisis (OECD, 2011a; Allain-Dupré, 2011).
- **Strengthening sub-national capacities holds potential for improving the efficiency and effectiveness of public investment.** Fifteen capacities have been identified as integral to sound design and implementation of public investment. These capacities relate to the various stages of the investment cycle, from planning to post-completion review. In some instances strengthening capacity may improve the quality of the investment choices (i.e. more growth-oriented, better tailored to sub-national specificities as a result of enhanced strategic planning efforts or more rigorous ex-ante appraisal). In other cases, capacity development may lead to efficiency gains as sub-national governments tap unexploited economies of scale (e.g. through cross-jurisdictional co-ordination) or reduce costs (e.g. through more competitive procurement or e-government tools).
- **Sub-national governments should pause to review the state of their capacities for effective public investment** (alone or in partnership with higher levels of government), identify gaps, and seek opportunities to strengthen their capabilities throughout the investment cycle. Particular attention should be given to identifying which weaknesses represent potential “binding constraints” on effective investment in the region in question. A diagnostic tool is provided to help identify which areas of capacity need strengthening at the sub-national level.
- **The decentralisation context in which sub-national public investment occurs affects what can be expected of sub-national governments.** Public investment is a shared responsibility among levels of government, but “who is responsible for what” varies among countries and across sectors. The greater the authority of sub-national governments throughout the investment cycle, the better developed their capacities must be. By contrast, where a higher level of government takes a leading role at different stages of the investment cycle (e.g. for ex-ante appraisal or procurement), the capacity of sub-national authorities to set the stage for, participate in, and use the results of these processes (e.g. through sound planning, effective negotiation, information sharing, or monitoring) can enhance governance.

- **Capacity development for sub-national public investment goes beyond a narrow focus on workforce improvement activities.** Because SNG capacities depend heavily on regions' institutional context, a systemic perspective is needed which embraces the nature and quality of institutions at all levels of government. Strategies for capacity development therefore include mechanisms for strengthening relations among levels of government, for identifying, sharing, and applying good practices across sub-national governments, and for strengthening the partnership role that higher levels of government play with respect to sub-national public investment. For sub-national authorities with limited authority over or resources for public investment, capacity development may focus more on working constructively, horizontally and vertically, with other actors in government – as well ensuring the availability of needed capacities, even if it is not feasible to possess them “in-house”.
- Capacity assessment and steps toward capacity development should bring together both top-down and bottom-up perspectives, and ought to take into account the need to provide sufficient scope, time, and resources for changes to take place.

Organisation of the paper

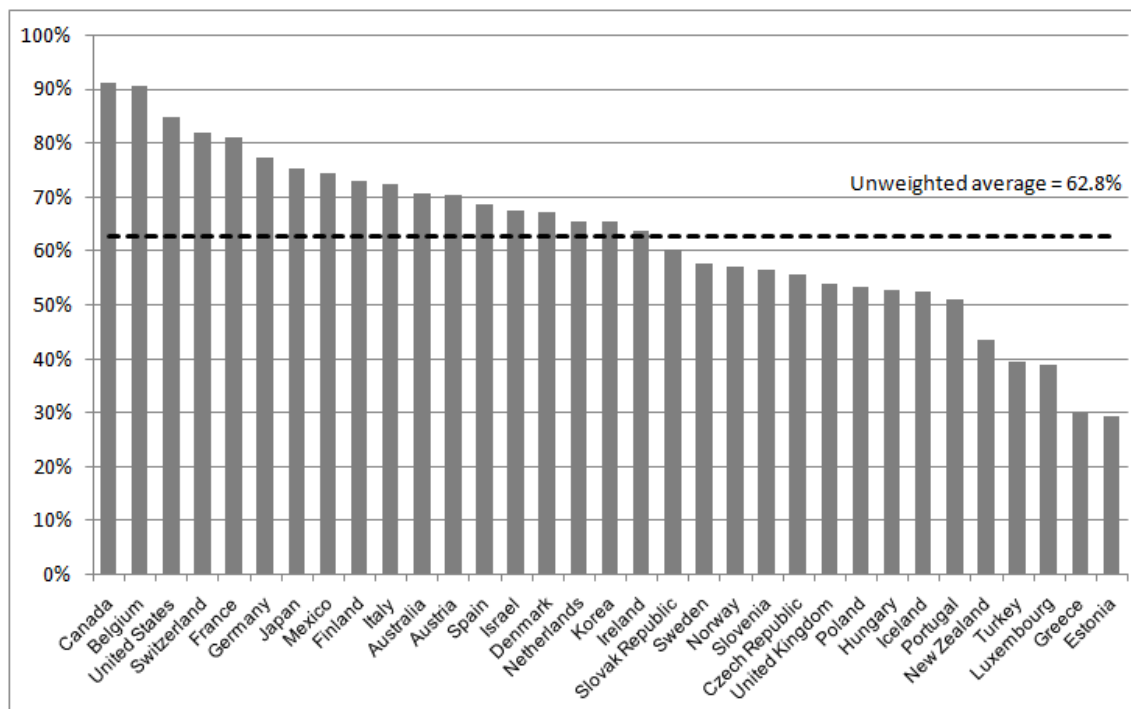
The remainder of the paper is organised as follows. The next section provides an overview of sub-national public investment in OECD countries and highlights why capacity matters for strengthening public investment. It is followed by an examination of 15 sub-national capacities relevant for enhancing public investment for regional development. The paper then offers a discussion of capacity assessment as well as a diagnostic tool to help sub-national governments discern the strengths and weaknesses of their governance capacities with respect to public investment. Finally, the paper concludes with a discussion of various mechanisms for strengthening overall capacity for sub-national public investment, including a checklist for higher-level governments.

Sub-national public investment: trends and capacity in context

The multi-level governance context

Public investment is a shared responsibility among levels of government, with most investment occurring at the sub-national level. On average, nearly two-thirds of public investment (public gross fixed capital formation, GFCF) occurs at the sub-national level (Figure 1). Federal countries usually have the highest SNG share of public investment (over 80% of GFCF in Canada, Belgium, and the U.S.), but some unitary countries have a share comparable to federal countries (i.e. France, Japan, and Finland). Unitary, historically centralised, or very small countries tend to have the lowest share (below 40% on average in Turkey, Luxembourg, Greece and Estonia). (Vammalle and Hulbert, 2013) Evidence suggests there is also substantial variation within countries: public investment can differ notably both in per capita terms and as a share of regional GDP among regions of the same country (OECD, 2011b).

Figure 1: SNG share of public GFCF in OECD countries, 2011



Source: OECD National Accounts as appears in Vammalle, C. and Hulbert C. (2013), "Sub-national finances and fiscal consolidations: Walking on thin ice", *OECD Regional Development Working Papers No. 2013/02*.

Box 1: Defining and measuring public investment

Public investment generally refers to capital expenditure on physical infrastructure (e.g. roads, government buildings etc.) and soft infrastructure (e.g. human capital development, innovation, and research and development) with a productive use that extends beyond a year. The way public investment is measured across countries varies. The statistics presented in this paper generally use public gross fixed capital formation (GFCF) as a proxy for public investment. GFCF is a useful but narrow definition since it does not cover all public spending that could be considered investment. In some cases, it can be difficult to determine the borderline between GFCF and public consumption. For example, acquisition of software with certain kinds of licenses or training of human capital will be classified as consumption, although such expenditures could have long-term repercussions. Research and development expenditures are “treated as capital formation except in any cases where it is clear that the activity does not entail any economic benefit for its owner in which case it is treated as intermediate consumption” (SNA, 2008: 122). Operations and maintenance can be classified either as intermediate consumption (current expenditure) or GFCF, according to their magnitude. Public-private partnerships are also not necessarily counted in public investment.

Note: GFCF is defined in the National Accounts as “acquisition less disposals of produced fixed assets, i.e. assets intended for use in the production of other goods and services for a period of more than a year. Acquisition includes both purchases of assets (new or second-hand) and the construction of assets by producers for their own use. The term produced assets signifies that only those assets produced as a result of a production process recognized in the national accounts are included. The national accounts also record transactions in non-produced assets such as land, oil and mineral reserves for example; which are recorded as non-produced assets in the balance sheet accounts and not as GFCF. Acquisition prices of capital goods include transport and installation charges, as well as all specific taxes associated with purchase.”

Sources: Excerpted with some modification from Vammalle, C. and Hulbert C. (2013), “Sub-national finances and fiscal consolidations: Walking on thin ice”, *OECD Regional Development Working Papers*; European Commission, IMF, OECD, United Nations and World Bank (2009), *System of National Accounts 2008*, pg. 122.

Responsibility for important aspects of public investment is shared among levels of government, and in some cases with the private sector. Financing for projects carried out by sub-national governments in the OECD area comes from multiple sources such as own revenues and borrowing, with grants from higher levels of government playing a vital role (de Mello, 2010; Dexia, 2012). Among EU countries, investment is generally financed via European Funds, national and sub-national funds, loans from the European Investment Bank or other banks, and private investors (Florio and Myles, 2011). Sub-national governments tend to have responsibility for infrastructure that confers largely local benefits (roads, urban transit, water supply, and waste management), while central governments tend to be responsible for utility infrastructures (e.g. telecommunications and power). In some cases large investments such as airports and ports are the responsibilities of sub-national governments, and increasingly technology is facilitating the transfer of responsibilities for utilities to sub-national entities. (Kappeler et al, 2012) In the United States, most transportation infrastructure is owned and operated by sub-national governments, while the private sector owns most freight rail infrastructure, dams, the energy grid, telecommunications systems, and half of drinking water systems (Posner, n.d.).

Trends in capital expenditures

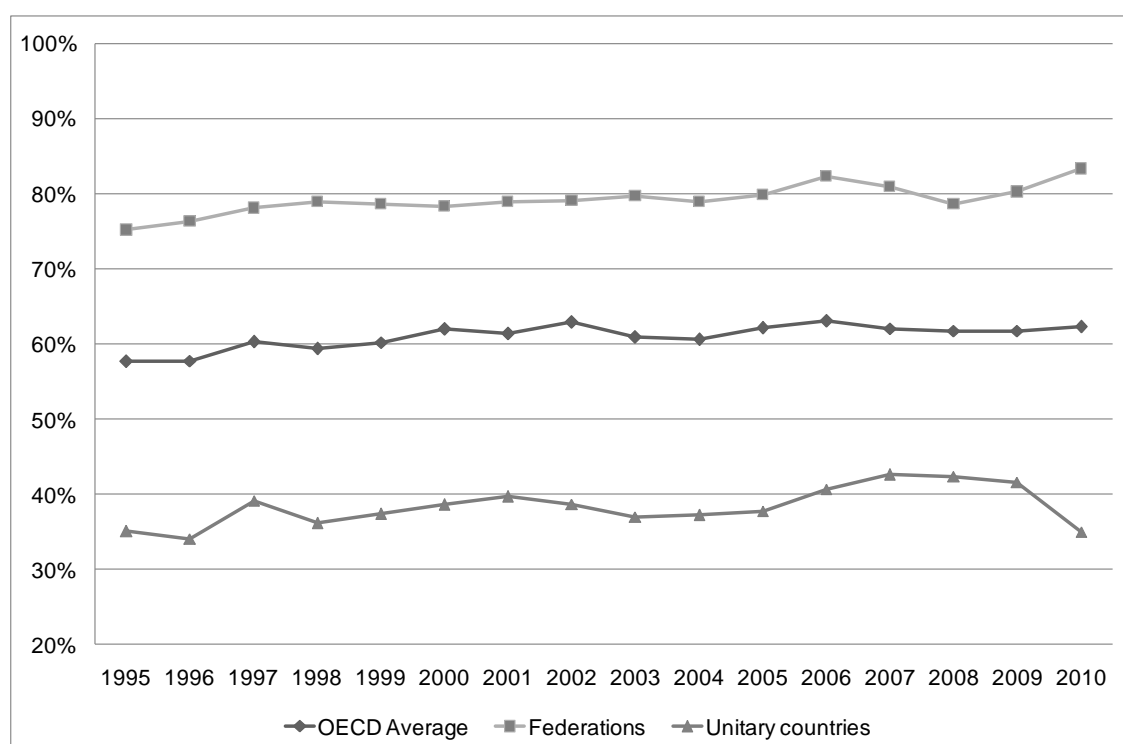
Overall, public investment – measured as government GFCF - has declined as a share of GDP in OECD countries since the early 1980s but remained relatively steady since the mid-1990s (Sutherland et al., 2009; Vammalle and Hulbert, 2013). This reflects a general decline in hard infrastructure investment, with most OECD countries already possessing well-developed infrastructure with limited scope for new investment. Emphasis rests on financing maintenance and upgrades, and improving efficiency (OECD, 2008a). As noted in Box 1, operations and maintenance can be classified either as intermediate consumption or GFCF, according to their magnitude.² The decline can also reflect a shift in investment type, from

2. In the U.S., for example, operating and maintenance (O&M) costs for transportation and water infrastructure have slightly exceeded capital expenditure since the mid-1970s. O&M currently

infrastructure to intangible investment that can appear as current expenditures in government accounts (e.g. human capital training). PPPs are also not necessarily counted as public investment. Importantly, the general trend masks some differences at the country level. Among EU countries, for example, until recently there was an upward trend in public investment as a percentage of GDP for Greece, Ireland, Portugal, and Spain (Perée and Vålilä, 2007). Finally, it is worth noting that in per capita terms, on average real public investment rose in OECD countries between 1995 and 2009, dropping off in 2010 and 2011 (Vammalle and Hulbert, 2013).

The weight of sub-national investment in total public fixed capital formation in the OECD area has risen slightly over time (Figure 2). This slight increase may reflect several factors: declines in national spending on GFCF, decentralisation trends in some OECD countries and the nature of the competencies transferred, and for EU countries – renovation and construction needs of public facilities and infrastructure in new member states, an increase in the cost of projects carried out³, and increased availability of credit and support from European Structural Funds (Dexia, 2011; Dexia 2012).

Figure 2: SNGs' GFCF as a share of total public GFCF, 1995-2010



Source: OECD National Accounts.

In the current constrained fiscal climate, public investment is an “adjustment variable” for many OECD countries and SNGs (OECD, 2011e; Vammalle et al, 2012; Vammalle and Hulbert, 2013). From 2007 to 2009, the implementation of recovery plans in many OECD and G20 countries led to higher levels of public investment at both national and sub-national levels. Sub-national governments benefitted from measures to boost investment

accounts for 52% of public spending in these areas, with sub-national governments accounting for nearly 90% of this spending. By contrast, SNGs account for 60% of public capital expenditures for transportation and water infrastructure, and the federal government the other 40% (U.S. CBO, 2010).

3. Bringing infrastructure in line with EU quality, safety, and environmental standards has had financial implications, particularly for countries lagging in these areas (Dexia, 2012).

through subsidies and capital grants, relaxed public procurement procedures, and looser deficit and debt constraints (Dexia, 2011). Now that these plans have been executed, many OECD countries are cutting public investment as part of fiscal consolidation efforts – in some cases below pre-crisis levels. Overall, sub-national public investment as a share of SNG expenditure dropped from 16.7% in 2007 to 15.4% in 2011 in OECD countries. This decline masks some variation across countries. Those countries most affected by long-lasting crises experienced the greatest declines (e.g. Iceland, Ireland, Spain, Greece), while others increased sub-national public investment over the same period (e.g. Poland, Mexico, Australia, Canada). Sustained and deep cuts in public investment are expected to continue in a number of OECD countries (e.g. Spain, Greece, Portugal, Luxembourg), while others plan to sustain or boost it (e.g. Estonia, France, Ireland, Denmark, Japan) (Vammalle and Hulbert, 2013).

Because public investment represents a growth-enhancing form of public expenditure, a sustained contraction in public investment at a time of sluggish growth is potentially costly.⁴ For regional development, the evidence suggests that the key areas of investment expenditure include transport and communications infrastructure, human capital development, innovation promotion and private-sector development (particularly efforts to foster entrepreneurship). In most OECD countries, the largest share by far tends to be devoted to transport infrastructure, which accounts for over one-quarter of cohesion spending in the EU (Crescenzi and Rodríguez-Pose, 2012). However, SNGs' investments in other spheres, such as healthcare and the provision of public amenities, may also serve regional development goals, even if not motivated by growth concerns in the first instance, since they directly affect both living standards and regional attractiveness to workers and firms, and they may indirectly affect productivity as well.

The role of governance capacity and institutional quality

With public coffers under strain, and governments seeking to achieve public investment goals under tight fiscal constraints, improvements in governance hold potential for improving the efficiency and effectiveness of spending. In recent years attention has focused on “public investment management” in order to improve the efficiency and effectiveness of public investment. Weak public investment management, it is argued, can undermine the positive contributions that such investment can make to growth. The literature has tended to focus on developing countries where investment planning, management, and oversight are frequently weak (e.g. Dabla-Norris et al., 2011, Rajaram et al. 2010) and where public spending does not necessarily translate into productive capital (Pritchett, 1996).⁵ While core aspects of the national governance of public investment in OECD countries may generally be sounder than elsewhere, problems emerge even among OECD countries. There is evidence, for example, that political economy considerations generate a bias in favour of investment in physical infrastructure, in particular (Haughwout, 2007; Crescenzi and Rodríguez-Pose, 2012). This can result in the construction of expensive “white elephants”. These poorly planned and managed projects often impose long-term costs on public budgets, extending well beyond the completion of the work, due, for example, to expenditures on the maintenance of facilities that may never yield an adequate return. Such “white elephants” are considered contributors to the current financial difficulties of Spanish regions in the aftermath of the global crisis. The airport

4. See Romp and de Haan (2007) for an overview of the large literature on public investment and growth.

5. This paper draws on two papers on public investment management for national governments: Rajaram et al identify eight “must have” features of national public investment systems: (1) investment guidance, project development, and preliminary screening; (2) formal project appraisal; (3) independent review of appraisal; (4) project selection and budgeting; (5) project implementation; (6) project adjustment; (7) facility operation; and (8) project evaluation. Diagnostic criteria for each of the elements are also provided. Dabla-Norris et al (2011) develop a composite Public Investment Management Index (PIMI) for 71 developing countries. The index incorporates 17 dimensions.

at Ciudad Real, south of Madrid, is estimated to have cost between EUR 356 million to EUR one billion: it opened in 2008 and closed in 2012 (Harter, 2012; Carvajal and Minder, 2012).

Evidence regarding the returns to “good governance” of place-based investment is somewhat scarce. Some findings, however, emerge from examination of EU Cohesion Policy and recent OECD research. Examining national data for 13 EU countries, Ederveen et al (2006) find that European Regional Development Fund (ERDF) allocations made between 1960 and 1995 were positively associated with national growth in GDP per capita when made to economies with sound national public institutions. In the absence of such institutions, the allocations were negatively associated with growth. At the regional level, there appears to be a positive association between perceived quality of institutions and growth for regions. Better quality of local government is associated with higher economic returns to Cohesion spending for regions receiving the largest sums per capita (Rodríguez-Pose, 2012). This measure of institutional quality, which captures public perception of local governance, reveals variation among countries in Europe as well as among regions (Charron et al, 2010). Looking at other research, Milio (2007) finds heterogeneity in regional administrative capacity in Italy to be linked to greater or lesser success in absorbing Structural and Cohesion Funds. The OECD found weaknesses in sub-national governance were among the factors that hindered the implementation of stimulus packages in the wake of the 2008 financial crisis (OECD, 2011a; Allain-Dupré, 2011).⁶

Improving governance capacities for public investment should be a priority for all regions, not only lagging ones – contrary to a widespread perception. Even in economically well-performing regions, there may still be scope for strengthening capacities. Recent analysis has shown that policy complementarities across investment priorities are critical (OECD, 2009c), and sub-national governments are well-placed to identify local needs and exploit synergies across investment priorities. If a region is to benefit from a new road, school or any other type of public investment, certain conditions in terms of complementary among local infrastructure or services need to be fulfilled (OECD 2011a). Infrastructure investment alone has little impact on regional growth unless it is associated with human capital and innovation (OECD, 2009c). Policy complementarities may sometimes emerge by accident, as the unintended by-product of interactions between sectoral policies. So, too, however, can undesirable and unintended consequences of uncoordinated policies. By contrast, better governance arrangements and good practices (capacities) that facilitate the development and implementation of an appropriate investment-mix can help governments to identify and pursue such complementarities deliberately, while trying to identify and avoid the kind of undesirable consequences that often emerge when policy co-ordination is weak.

Finally, governments facing tight budget constraints may seek to engage private financing for public investment. This money is more likely to flow to governments with well-developed capacities throughout the investment cycle. As one report notes, “whether or not private financiers choose to invest is determined not just by the details of the specific transaction but also by the wider political, legal, and economic environment, including any uncertainties about how governments themselves may act at any stage... seeking private-sector participation is no substitute for developing the institutions that create an environment conducive to investment” (WEF, 2010: x).

Taken together, these findings underscore the value in developing sub-national capacities. The following section examines 15 different capacities which hold potential for improving the efficiency and effectiveness of sub-national public investment: doing more or better with limited resources.

6. Other factors included the short timeframe for spending and the “lumpiness” of the funding (large, one-time allocations for investment) (OECD, 2011a).

Sub-national governance capacities: challenges and good practices

This section examines sub-national governance capacities that hold potential to strengthen public investment, as well as the challenges currently confronted in these areas. To narrow the field of important capacities, specific attention is given to those capacities that reflect four principles. Drawing on related literature, capacities have been selected that: 1) facilitate design and implementation of an investment portfolio that promotes regional development, 2) reflect the multi-level governance context of sub-national public investment, 3) reflect good practices in public investment management and OECD principles for good governance, and 4) are generally applicable, but allow for setting priorities in regions with differing characteristics. The result is a suggestion of 15 capacities that correspond to five governance goals, each associated with different stages of the investment cycle (Table 1).

Table 1: Sub-national capacities for effective management of public investment

Stage of the Investment Cycle	Goal	Capacity
Planning and project selection	To design an investment portfolio that encourages regional development	1. To engage in planning that is tailored, results-oriented, realistic, forward-looking and coherent with national objectives ★
		2. To co-ordinate across sectors to achieve an integrated place-based approach
		3. To co-ordinate with other jurisdictions to promote complementarities and achieve economies of scale across boundaries
		4. To involve stakeholders in planning to enhance the quality and support for investment choices – while preventing risks of capture by specific interests
		5. To conduct rigorous ex-ante appraisal ★
Financing and budgeting	To ensure adequate resources	6. To link strategic plans to multi-annual budgets
		7. To tap traditional and innovative financing mechanisms for public investment ★
		8. To mobilise private sector financing, without compromising long-term financial sustainability of public investment projects
Implementation	To ensure accountability for public resources and	9. To engage in transparent, competitive, procurement processes with corresponding internal control systems ★
		10. To design and use monitoring indicator systems with realistic, performance promoting targets ★
Evaluation	To promote results and learning	11. To conduct regular and rigorous ex-post evaluation
		12. To use monitoring and evaluation information to enhance decision making
Throughout	To support all stages of the investment cycle	13. To monitor and manage risks to integrity and accountability throughout the investment cycle
		14. To engage in “better regulation” at sub-national levels, with coherence across levels of government
		15. To ensure the quality and availability of technical and managerial expertise necessary for planning and executing public investment ★

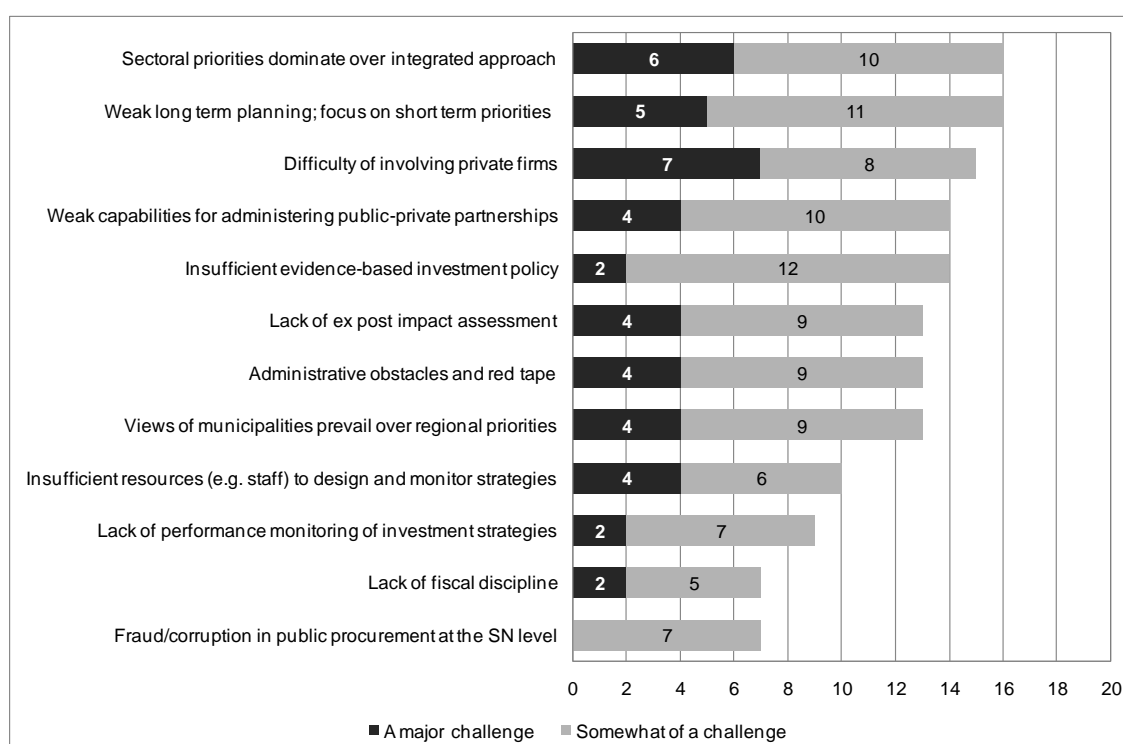
Notes: ★ = Critical capacity.

Sources: Authors' elaboration based on a review of relevant literature. In particular: Dabla-Norris, E. et al. (2011), “Investing in Public Investment: An Index of Public Investment Efficiency”, *IMF Working Paper 11/37*; Milio, S. (2007), “Can administrative capacity explain differences in implantation performances?”, *Regional Studies*, Vol. 41, No. 4, pp. 429-442; Rajaram, A. et al. (2010), “Framework for Reviewing Public Investment Efficiency”, World Bank Policy Working Paper, No. 5397 (August), 17, Washington, DC.

In many ways, the capacities in Table 1 represent an ideal. In practice, sub-national governments experience challenges in various areas – although national and sub-national governments take different views regarding their relative salience. National governments report weaknesses in many areas of sub-national capacity, but difficulties implementing a cross-sectoral approach, weak long-term strategic planning, and challenges engaging the private sector top the list (Figure 3). In some ways, surveyed regions see the challenges differently. While also viewing private sector engagement as problematic, they tend to emphasise implementation challenges such as financial constraints, public procurement capacity, and constraints on hiring qualified staff (Table 2).

Figure 3: Governance capacity challenges facing sub-national governments

As perceived by central governments (n=20)



Source: OECD national questionnaire on multi-level governance of public investment, 2012.

Table 2: Main public investment capacity challenges for sub-national governments

As seen by national governments (n=20)	As seen by regional governments (n=7)
<ul style="list-style-type: none"> Sectoral priorities dominate over integrated approach Weak long term strategic planning for public investment; a focus on short term priorities Difficulty of involving private firms Weak capacities for administering PPPs 	<ul style="list-style-type: none"> Lack of involvement of private actors Reduced fiscal capacity for public investment Lack of capabilities to administer public procurement Excess of administrative procedures and red tape Public employees' salaries not competitive with the private sector

Source: OECD national and regional questionnaires on multi-level governance of public investment, 2012.

The remainder of this section describes each of the 15 capacities that hold potential to strengthen sub-national public investment, challenges being confronted, and good practices in each area.

Developing an investment portfolio that encourages growth

A sub-national government's capacity to assess needs and select an appropriate investment portfolio is an essential capacity – both for ensuring adequate provision of basic services and for encouraging growth. The planning phase for investment is among the most critical aspects of public investment management due to the long-term nature of project implementation and the long life of the resulting assets (Dorotinsky, 2008). Effective planning sets the stage for sound project selection, budgeting, partnership-building, and monitoring. Five capabilities related to the planning phase are described here: strategic planning, cross-sectoral co-ordination, cross-jurisdictional co-ordination, stakeholder involvement, and ex-ante assessment.

Capacity 1: Strategic planning

Strategic and capital planning for public investment should lead to an investment mix that ensures adequate public services and encourages growth. Evidence suggests regions' growth is driven mainly by endogenous factors, including human capital, innovation, agglomeration economies, the quality of institutions, and, in certain circumstances, infrastructure (OECD, 2009c; OECD, 2011e; Garcilazo et al, 2010). Planning activities that identify and seek to mobilise regions' assets (sources of competitiveness) are thus integral to effective planning for investment. An asset-based approach to planning (versus a need-based approach) recognises regions' tangible and intangible assets as springboards for and facilitators of economic growth. (Yigitcanlar and Velibeyoglu, 2008) Inevitably, the asset mix, path to growth, and investment mix will vary among regions.

Although the path to growth differs among regions, the planning process should lead to an investment mix that adheres to common principles. First, the portfolio should be *tailored*. Investment choices should be linked to a development strategy based on assessment of regional (or local) characteristics and specific competitiveness factors, with a correspondence between investments and regional needs.⁷ Not only is this important for developing a coherent approach to service delivery and economic growth, but it signals to potential private investors that investment opportunities reflect real needs and, as such, are more likely to receive public and political support.⁸ Second, the portfolio should be *results-oriented*: designed with attention to national and sub-national development goals, complementarities and potential conflicts among sectoral investments, and the need to invest in both hard and soft infrastructure. Third, investment priorities should be *realistic and well-informed*: thoroughly assessed, properly prioritised, and funded with a multi-year budget envelope. Attention should be given to ensure that priority-setting is not driven by the inertia of out-of-date previous plans and assumptions, or by narrow political considerations (World Bank, 2008). Finally, the investment mix should be *forward-looking*, with investments that can position regions for competitiveness in the global economy and attention to the importance of sustainable development. Region Skåne's clean tech investment focus provides a good example (Gamper, 2012b).

7. For example, in comparing and contrasting the administrative capacity of the Italian regions of Sicily and Basilicata to spend EU Cohesion Funds during the 2000-2006 programming period, Milio (2007: 438) notes that “over the first two periods of planning, [Sicily's] specific characteristics were overlooked. Due to the lack of correspondence between planned interventions and real territorial needs, very few projects were presented requesting Funds... [ultimately] making it almost impossible to spend resources.” By contrast, “the programme presented by Basilicata closely adhered to the necessities of the region, and focused on actions that corresponded to subsequent requests and investment of resources by private firms”.

8. The World Economic Forum identifies policy and political support as two of eight “key factors in a successful infrastructure project programme”. These are signalled, not least, by demonstrating “that the [investment] program is fully integrated with and reflects a country's infrastructure needs and has mainstream support” (WEF, 2010: 33).

Despite its importance, sub-national capacities for investment planning appear to need bolstering. Central governments responding to the OECD questionnaire view the most important capacity challenges for regions/municipalities to be related to strategic planning. Some 80% of respondents (i.e. 16 OECD countries) consider lack of a long-term view to be a challenge for sub-national governments. Moreover, 65% of national governments responding worry that municipal views prevail over regional priorities. In some countries (e.g. Slovenia), this means that regional strategic planning sometimes results in outcomes that are neither strategic nor regional in scale – they are rather a compendium of municipalities’ immediate wishes (OECD, 2011c). Finally, 14 countries consider insufficient evidence-based investment policy (lack of economic research on regional needs) at the sub-national level to be a challenge.

Strengthening strategic/capital planning skills can have positive effects for other dimensions of capacity discussed here. Good strategic planning is not only about the plans themselves, but also about the process: the stakeholders it brings together, the knowledge generated, and the basis it can provide for managing risks over the course of the investment cycle. The planning stage can be particularly important in a context where regions have relatively low authority over key aspects of public investment. In Skåne, for example, it is the central government that plays a lead role in areas such as financing and ex-ante appraisal for certain investments (e.g. transport) (Gamper, 2012b). In Germany, the central government consults with regions (Länder) regarding investment projects, but ultimately decides what will be financed. Implementation is left to the Länd (Gamper, 2012a). These types of arrangements place a premium on effective vertical co-ordination arrangements. Developing a common understanding with the central government of regional investment needs and the way forward becomes critical for ensuring that those aspects of investment that are not under sub-national control proceed in a manner consistent with both national and regional goals.

Capacity 2: Cross-sectoral co-ordination

Cross-sectoral co-ordination can help to cultivate synergies among strategies, specific investments, and between hard and soft infrastructure. Attention to potential complementarities (or possible conflicts) can strengthen the impact of investment. For example, adequate infrastructure, particularly connective infrastructure, is important – but without simultaneous upgrading of human capital, long-term growth is likely to be weak (OECD, 2009c). Infrastructure intervention needs to be co-ordinated with other strategies such as developing human capital, strengthening the innovative potential of regions, and other policies (e.g. business support, institutions) (Rodríguez-Pose, 2012). Complementarities can be sought at both the macro level (aligning investments in housing and transportation) and the micro/project level (constructing a technology centre in a region with skilled researchers and/or firms ready to tap innovation support).

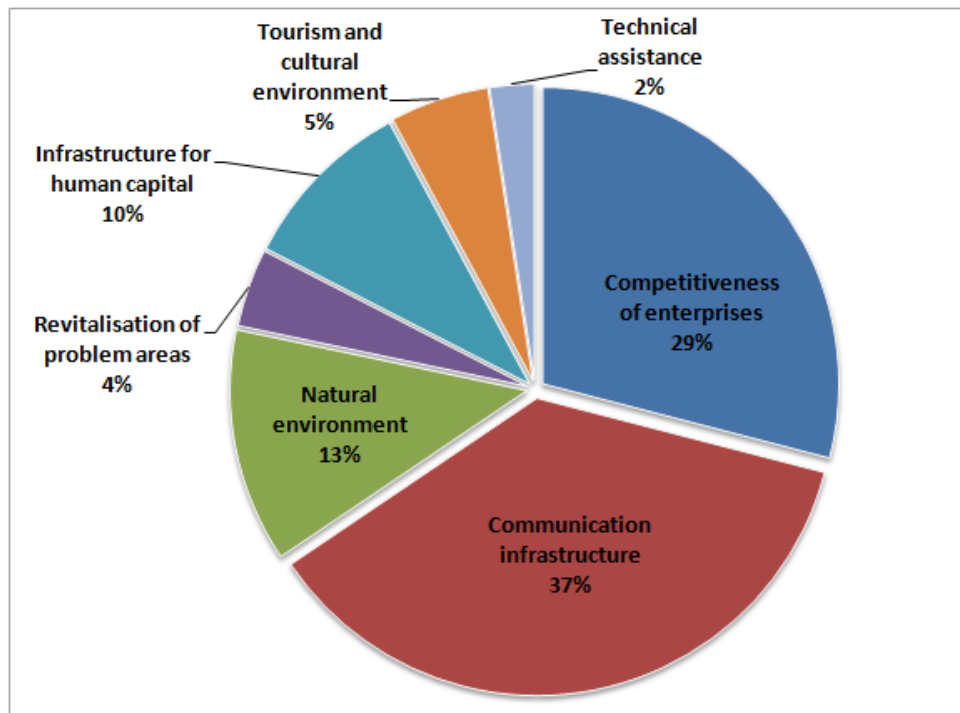
Cross-sectoral co-ordination can represent an important capacity gap for sub-national governments. From the national perspective, difficulties achieving a cross-sectoral approach to investment top the list of capacity challenges facing sub-national governments (Figure 3). Doing it well requires identifying where the potential for complementarities across investment priorities lie (for example across transport and ICT projects) and developing the governance arrangements for these complementarities to be fully exploited, i.e. going beyond the traditional perimeters of sectoral administrations. Higher levels of government can play a critical role in facilitating sub-national cross-sectoral co-ordination by allocating of funds by strategic priorities rather than solely on the basis of sectoral programmes. They can also capitalise on their “convening authority” to bring together sectoral actors that might not do so of their own accord. The U.S. “Strong Cities, Strong Communities” initiative, for example, brings together all 19 federal agencies to provide technical assistance and support for distressed cities (see Box 11). At the regional level, the presence of an overarching investment strategy or joint committees across sectors can facilitate this co-ordination. Sub-national governments can also

draw on external support, such as regional development agencies, to help facilitate an integrated approach to regional development planning.

Although developing an integrated place-based approach to public investment is challenging, important steps are being taken. Among surveyed regions, most have a regional-level strategic investment plan setting out investment priorities in the region - although it is frequently not binding. Without stakeholder input and political support, such non-binding documents may have limited impact in practice. In the EU, regions have been asked to allocate funding in a balanced way across hard and soft infrastructure priorities, avoiding the mistakes of the 1970s-80s when the vast majority of EU funding was allocated to physical infrastructure projects. For example, in Poland, regions must allocate at least 40% of the funding to Lisbon-innovation related objectives. In the Wielkopolska region, the Regional Operational Programme (ROP) for 2007–2013 is the region’s first large-scale multi-annual development programme guiding public investment and effort has been made to balance investment priorities across sectors (see Figure 4).

Figure 4: Regional Operational Programme for Wielkopolska, 2007–2013

Financial breakdown of investment priorities (% of total ROP budget)



Source: European Commission (2012), “Operational programme 'Greater Poland’”, Regional Policy, Infregio website, last updated 7 September 2012.

Capacity 3: Cross-jurisdictional co-ordination

Issues of scale and cross-jurisdictional complementarities require adequate attention during the planning phase. Sub-national horizontal co-ordination is essential to encourage investment in areas of positive spillovers, to increase efficiency through economies of scale, and to enhance synergies among policies of neighbouring (or otherwise linked) jurisdictions. It is critical for physical infrastructure provision where the minimum efficient scale of projects transcends boundaries of individual regions. It can also pay dividends in areas like human capital development and innovation in conditions where functional economies cross administrative borders. The importance of cross-border synergies is highlighted by recent research that suggests that in some settings, spillovers from certain types of public investment

(e.g. public and transport infrastructure) can prove more relevant for regional growth than direct investment in each region. In Greece, “public (transport) infrastructure investment in one region tends to complement investment in other regions, making the influence of intervention felt well beyond the borders of the prefecture where it takes place”. (Rodríguez-Pose et al, 2012) For these reasons, horizontal co-ordination arrangements and complementarities (or potential tensions or contradictions between different strands of policy) ought to be explicitly considered during the planning stage, with sub-national governments co-ordinating their planning efforts. Horizontal co-ordination mechanisms range from government mergers on the one hand to arrangements such as joint municipal authorities, joint purchasing of services, collaborative co-financing, strategic alliances, etc. on the other.

Sub-national governments can cultivate specific capabilities to help facilitate cross-jurisdictional co-ordination. There is a need, for example, to identify possible areas for collaboration, estimate the value of collaborating, and the pros and cons of an appropriate model for doing so. Benchmarking other cases of cross-jurisdictional co-ordination for public investment in the same sector or in similar regions can be helpful in this regard. Gauging and mobilizing political support can also be critical to move such projects forward. (Oftele, 2010) This said, **the willingness of sub-national governments to collaborate is likely to vary with the type of investment(s) being considered.** It is likely to be easier, for example, to collaborate around investments in basic infrastructure and service provision (e.g. water, sewage) and more difficult around “strategic” investments where sub-national governments might find themselves competing to secure public facilities, to attract intergovernmental grants, or to attract firms and jobs (e.g. higher education, innovation). Despite hurdles, the search for economies of scope and scale do lead SNGs to co-operate around public investment. Box 2 highlights examples from Brandenburg (Germany) and Galicia (Spain). In another example, nine local governments in the U.S. aim to reduce costs by collaborating via a single regional power purchase agreement to procure renewable energy technology for 70 public-sector sites, ranging “from bus depots and health centres to prisons and police stations” (Wilson et al., 2011).

Issues of scale can be particularly problematic in countries with high levels of administrative fragmentation. Substantial fragmentation, particularly at the local level, affects the type of investments that are prioritised, which tend to be smaller-scale projects with a lower return on investment. Investments that generate a payback across a much larger area (i.e. where there are positive externalities to be realised) may be under-developed. This was noticeable in the implementation of investment stimulus packages in 2008-09, when municipalities, rather than higher tiers of government, were the main implementers of investment stimulus funding in Spain and in France. In Spain for example, 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. In France, instruments for co-operation among the 36 000 municipalities exist have not been substantially used in the aftermath of the crisis. (OECD, 2011a)

Higher levels of government can encourage cross-jurisdictional co-ordination, particularly for investment priorities for public goods with high externalities (e.g. public transport, water, environmental goods or higher education). Fourteen countries indicate they have specific mechanisms to encourage co-operation across municipalities for public investment; 12 countries report mechanisms to foster co-operation among regions. Portugal, for example, required in its 2007-2013 National Strategic Reference Framework that each municipal association develop a Territorial Development Plan as a precondition for the EU grant. Groups of municipalities received funds. A 2008 law also encourages inter-municipal co-operation. Slovenia introduced a financial incentive in 2005 to encourage inter-municipal co-operation by reimbursing 50% of staff costs of joint management bodies – leading to a notable rise in the number of such bodies (OECD, 2011c). In Norway, regional industrial development funds encourage inter-municipal co-ordination. In Switzerland, one-third of funds for regional development policy are reserved for projects involving inter-cantonal co-operation (OECD, 2011d).

Box 2: Cross-jurisdictional co-ordination for public investment: Examples from two regions

Horizontal co-ordination between Brandenburg and Berlin

Despite some barriers to potential horizontal collaboration, strong co-operation has emerged between the German regions of Brandenburg and Berlin. For example, the two regions are engaged in joint spatial planning (important for enabling Brandenburg to control urban sprawl from Berlin), are collaborating with the federal government around a new airport, and have established a harmonised transport network. In addition, in an effort to establish critical mass in selected fields of innovation, the two Länder have developed a joint innovation strategy. On the positive side, the joint strategy has facilitated collaboration among individual organisations across the two Länder. For example, a biotechnology centre, financed by both Länder, was founded to serve as a platform for exchanges between companies and research institutes across Länder. On the other hand, the strategy is not backed by shared financing. The two Länder parliaments appear reluctant to vote in favour of joint budgets for the innovation sector. In addition, an important source of regional innovation funding comes from EU structural funds, which – at present- may not be shared by two Länder.

Inter-municipal co-ordination in Galicia (Spain)

The region of Galicia, Spain has large number of small municipalities, many with limited institutional capacity and diffuse settlement patterns that increase the cost of providing public services. The regional government has taken step to encourage economies of scale. First, it has improved the flexibility of and provided financial incentives for voluntary (“soft”) inter-municipal co-ordination arrangements. Investment projects that involve several municipalities get priority for regional funds. “Soft” inter-municipal agreements tend to be popular in the water sector. Local co-operation is also being encouraged in the urban mobility plan for public transport, involving the seven largest cities in the region. The regional government also imposed a (“hard”) co-ordination arrangement. Specifically, it created the Metropolitan Area of Vigo, an association of 14 municipalities. Although the metropolitan area was defined by the regional government, it was based a history of “light co-operation” among 12 municipalities (out of 14). Voluntary municipal mergers may be encouraged in the future.

Sources: Excerpted with slight modification from Gamper, C. (2012) “Public Investment across Levels of Government: The case of Brandenburg, Germany” and from Hulbert, C. (2012), “Public Investment across Levels of Government: The case of Galicia, Spain”, reports for the 28th OECD Territorial Development Policy Committee, 4-5 Dec 2012, available online at www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm and in summary form in OECD (forthcoming), *Investing Together Across Levels of Government: Meeting the Co-ordination and Capacity Challenges*, OECD Publishing.

At the sub-national level, the German Länd of Brandenburg has seen the creation of 15 regional core growth areas aimed to improve co-ordination at the sub-regional level. They are determined by a critical mass of inhabitants and business activity (Gamper, 2012a).

Capacity 4: Stakeholder involvement

Involving stakeholders, such as citizens, universities, and private sector actors, can improve the quality of planning efforts. Stakeholder involvement can establish a shared vision for development, improve assessment of investment needs, reveal the importance of cross-border linkages, strengthen trust in government, and cultivate support for specific investment projects. It can also lead to demand-driven improvements in public investment management capacity. In practical terms, this means that SNGs should have processes in place for stakeholder involvement in policy development and needs assessment in early stages of the investment cycle, and feedback and evaluation in later stages. Capacities for effective stakeholder involvement include, but are not limited to: 1) identifying stakeholders, understanding their “stake” and their right to and capacity for engagement, 2) designing outreach to and consultation opportunities for stakeholder groups, 3) selecting the right technique to involve stakeholders, 4) developing a stakeholder communication strategy (e.g.

Box 3: Engaging citizens and firms in regional economic planning

As part of an effort at decentralisation in England in the late 1990s, the central government created nine Regional Development Agencies (RDAs) whose goals included enhancing regional economic development and competitiveness. The RDAs did so, in part, by leading the development of a Regional Economic Strategy (RES) in co-operation with partners in their regions every three years. The RES laid out the region's main economic development priorities, offered a strategic assessment of the challenges and opportunities facing the region, and provided a framework within which stakeholders could act.

In 2003, One NorthEast, the RDA for the northeast of England, launched SHiNE (Shaping Horizons in the North East), a 14-month futures-scenario building project intended to take advantage of local knowledge and create buy-in for the 2006 regional economic strategy. SHiNE represented a new approach intended to capture a broader spectrum of views than in the past. The project – which cost an estimated GBP 250 000 – engaged over 1 000 stakeholders in interviews, workshops and presentations regarding the issues and drivers impacting the region and its economic development. SHiNE engaged or reached the private, public and voluntary sectors, as well as academics, students, faith communities and others.

According to an ex-post evaluation, SHiNE influenced the 2006 RES in a number of ways. First, it highlighted areas where the previous strategy fell short. The lack of attention to the issue of leadership, the inward-looking focus, the lack of definition of clear priorities, and lack of emphasis on distinct regional assets and opportunities in the first RES were subsequently addressed in the 2006 strategy. Second, eight priority areas identified by SHiNE contributed to the structure of the revised RES. Credit was given to SHiNE for revealing the importance of “Business, People and Place” – the themes around which the RES and related documents were organised. Some proposals emerging from SHiNE were deemed too radical to include in the RES, suggesting the process pushed the boundaries of thinking about regional economic development in the region. The usefulness of SHiNE was further reflected in the references to the process and outcomes in multiple One NorthEast strategy documents, such as its 2005-2008 Corporate Plan. Finally, the evaluation pointed to positive effects on strategic thinking and the value of bringing together diverse stakeholders to exchange ideas.

In 2012, One NorthEast was abolished, along with the other English RDAs, and replaced with Local Enterprise Partnerships as a cost-saving measure. SHiNE, however, remains an ambitious example of engaging regional stakeholders in economic planning.

Source: Excerpted with slight modification from Mizell, L. (2009), "Building Future Scenarios for Regional Development in Northeast England, United Kingdom", in OECD (2009), *Focus on Citizens: Public Engagement for Better Policy and Services*, OECD Studies on Public Engagement, OECD Publishing, doi: 10.1787/9789264048874-en.

accessible public reporting of investment plans, implementation progress, and results), and 4) managing grievances (OECD, 2004b; IFC, 2007).⁹

Data from surveyed regions suggest that involvement in investment planning could be bolstered among certain groups of stakeholders. For most case study regions, consultation with municipalities when elaborating a regional development strategy is common practice. However, involvement of citizens, academics and NGOs in the design of regional investment strategies is less common, and banks and private actors are the least involved in the design of these strategies. Sharing of good practices and experiences could be helpful in this regard. For example, “the New South Wales government in Australia requires all public-private partnership project proposals to consider environmental and community issues, alongside financial and budgetary factors prior to receiving government support. This ensures that all appropriate stakeholders are involved, including the government, the private sector, and the community”

9. The OECD has published extensively on the topic of consultation processes, citizen engagement, and stakeholder involvement. See for example, OECD (2001 and 2009d). Two other publications are also useful. IFC (2007) targets companies doing business in emerging markets. Despite this focus, the definitions and guidance are useful for multiple audiences and for different contexts. OECD (2004b) provides brief guidance on stakeholder involvement and offers a useful annotated bibliography of various related publications, including numerous reports published by the OECD.

(WEF, 2010: 27). In the U.S., it is not uncommon for local and regional transportation planning to include public engagement plans that outline a process for involving stakeholders.¹⁰ Box 3 presents an example of public participation in regional economic planning in England.

Private sector actors can play different roles at different stages of the public investment cycle, but risks of capture by specific interests need to be managed. Among surveyed regions, most involve private actors in the design of investment projects. The areas where the private sector involvement is the most solicited are transport and environment, and to a lesser extent, innovation and regional development. In some regions, the private sector is involved in investment projects related to hospitals, schools, ICT infrastructure and culture. As stakeholders in public investment decisions, private actors can offer potentially important information for regional development planning and implementation of investment strategies. However, the benefit of information needs to be balanced by measures to prevent capture, particularly where firms prioritise creation of a future markets for themselves rather than strategies best fitting a particular region (OECD, 2009f). Once private contracts have been awarded, private partners can also contribute to strategies for communicating and consulting with the public. Public authorities can encourage them to adopt a high degree of transparency, provide comprehensive information regarding project parameters and the state of infrastructure operations, and actively engage around environmental and social impacts of their activities (OECD, 2007a).

Capacity 5: Ex-ante appraisal

Ex-ante assessment is critical for sound project selection. These assessments drive investment decisions. They should therefore be technically sound, with larger projects requiring more rigorous analysis (Dabla-Norris et al, 2011), and enable a selection of investments based on economic value, after also considering alternatives to investment to reach particular goals (Posner, n.d.; Laursen and Myers, 2009). Ex-ante appraisal should also take account of possible policy and project complementarities. High-quality ex-ante assessments offer considerable benefits as part of the decision making process. As Florio and Myers (2011: 9) note, “serious scrutiny of investment decisions can counteract distortions induced by budget constraints and poor institutional environment.” Ex-ante assessment tools for investment projects include cost-benefit analysis (CBA), economic impact assessment, cost-effectiveness analysis, and risk assessment. Most case study regions use CBA based on their own initiative rather than because it is required by the central government or supra-national organisations.

Unfortunately, even when ex-ante appraisals are conducted, they are not necessarily systematically used by sub-national governments for decision making, nor are they necessarily of the appropriate quality. In the U.S. for example, the Government Accountability Office reports that “many state and local transportation agencies are not consistently using formal economic analysis as part of their investment decision-making process to evaluate project alternatives [for highway and transit investments]”, although some assessment of costs and/or benefits is generally undertaken (US GAO, 2005: 23). Even within the EU where regulations require cost-benefit analysis of major investment projects financed with Cohesion Funds, the incentives to initiate new projects or to absorb EU funds can overshadow the incentives to achieve value-for-money in public investment. The quality of ex-ante analysis is not necessarily high, and countries may face the incentive to finance projects which are sub-optimal but ready-to-go in order to avoid losing funds. (World Bank, 2008) Independent review of ex-ante assessment can and should be employed in order to improve quality assurance (World Bank, 2008; Rajaram et al, 2010; Dabla-Norris et al, 2011).

10. See, for example, the 2011 U.S. State of Illinois’ “State Rail Plan – Stakeholder Involvement Plan”.

Box 4: State of Victoria, Australia: the “High Value High Risk” process

The Department of Treasury and Finance in the state of Victoria has accountability for assuring the quality of major public investment proposals. In 2010, the government established a “High Value High Risk” (HVHR) process largely in response to the experience of a range of major projects incurring significant time and cost overruns. The process requires infrastructure and ICT projects identified as being high value and/or high risk to undergo rigorous scrutiny and approval processes, involving increased central oversight over various stages of investment development, procurement and delivery. This includes a requirement to obtain the Treasurer’s approval of project documentation at key stages of the project’s lifecycle and to undergo compulsory Gateway Reviews and active monitoring throughout the life of the project. The objective is to ensure that major infrastructure and ICT investments are delivered successfully, on time and on budget. The process applies to all general government sector infrastructure and ICT investments with a total estimated investment of AUD 100 million or more (whether funded by the government or in conjunction with the private sector) and/or projects identified as high risk under the Gateway Project Profile Model, which assesses the potential impact and complexity of the project.

Source: Excerpted with slight modification from Bounds, G. (2012) “Public Investment across Levels of Government: The case of Victoria, Australia”, report for the 28th OECD Territorial Development Policy Committee, 4-5 Dec 2012, available online at www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm and in summary form in OECD (forthcoming), *Investing Together Across Levels of Government: Meeting the Co-ordination and Capacity Challenges*, OECD Publishing.

The challenge of ex-ante evaluation is likely to be greatest where it is most needed: where there is considerable uncertainty about the factors affecting returns on investment.

Commonly used approaches to CBA are most effective where there is a great deal of information about the project, the context, and the risks involved over the investment cycle. For example, it might be relatively straightforward to assess the potential gains from the relaxation of a transport constraint on a well-travelled route or an expansion in provision of an established service. By contrast, far greater analysis is required for major new infrastructure, which might substantially alter existing traffic flows and/or generate new ones or introduce an altogether new form of service provision. Complex, costly, and lengthy “mega projects”, which often involve private partners, can also require elaborate appraisal techniques that go beyond traditional CBA. PPPs, for example, can require “additional dimensions of analysis in order to assess the locus of risk bearing in the contractual arrangement.” (UNCTAD, 2009: 10) The state of Victoria in Australia has developed a noteworthy “High Value High Risk” process which reflects the importance (and difficulty) of sound ex-ante appraisal for certain investments. It requires enhanced ex-ante assessment and control of projects which exceed a defined monetary threshold, or are otherwise considered high risk (Box 4).

While policy makers urgently seek paths to growth, focusing exclusively on the benefits of public investment in terms of growth and productivity can lead to its undervaluation. More precisely, policy makers must attend to multiple policy objectives – promoting growth as well as poverty reduction, environmental sustainability, equitable access to basic services, etc. (UNCTAD, 2009). Some forms of public investment may be justified chiefly in terms of their direct consumption benefits to households, or to their contribution to other policy goals, rather than for their growth impacts exclusively. Growth-enhancing complementarities may arise, though, even for investment in public services. For example, investment in water infrastructure is basic public service provision, but it may also facilitate economic activities in a place. Investments in human capital have immediate benefits but also pay-off well into the future, and represent critical complementarities with other forms of investment. Some of these benefits are less easily quantified and incorporated into standard cost-benefit analysis (UNCTAD, 2009), but should nonetheless be identified and considered as part of the planning and selection process. While growth objectives are crucial, an exclusive focus on the returns to public investment in terms of growth and productivity will lead to an under-estimation of its real social returns and may also generate an unwarranted bias in favour of some forms of investment at the expense of others.

Because the utility of ex-ante assessments depends on the technical capacity of the organisations and individuals undertaking them (Rajaram et al, 2010), it is valuable to assess and strengthen the presence of such competencies at the sub-national level. Assessing the availability of in-house technical skills among public servants can be helpful in this regard (suggestions are provided later). Formal guidance regarding ex-ante appraisal can also boost technical capacities and ensure common understanding among practitioners at different levels of government, across sectors, and – in the case of EU Cohesion Policy – across countries. The European Commission (2008) makes available a “Guide to Cost-Benefit Analysis of Investment Projects” for use in the context of EU Cohesion Policy, and finances training for researchers and practitioners on the topic as well. However, for major projects where appraisal is particularly complex, it is also important to assess the availability of technical expertise in organisations or units (public or private) with independence, experience, and a good reputation in these areas. For sophisticated projects, such as “mega-projects” or projects with network characteristics, technical requirements may extend beyond standard project appraisal skills and require specific types of expertise (e.g. engineering). This is one factor that encourages governments to establish special purpose arms-length public bodies outside the core public service. The complexity of good ex-ante appraisal has led some to suggest “dedicated institutional units for project analysis and assessment and network design and management” at the central government level, with similar units at sub-national levels “to assess and judge projects according to nationally set technical guidelines” (UNCTAD, 2009: 11).

Ensuring adequate resources

Ensuring adequate resources for public investment projects is a major challenge for sub-national governments in OECD countries. The 2008 financial crisis has led to heavy budget constraints on all levels of government. While sub-national governments received a temporary boost to public coffers from national anti-cyclical measures, these measures are expiring. Fiscal consolidation is affecting all levels of government and for many sub-national governments public investment is an adjustment variable (i.e. other expenses remain relatively stable while public investment expands or shrinks as fiscal circumstances change). As a short-term response, some retrenchment on the investment side is normal and probably unavoidable – other items of expenditure are less easy to adjust quickly. However, the prospect of an extended period of austerity in many OECD countries raises the risk of significant under-investment, with deleterious long-term consequences for both growth and service provision. Regions in the coming years will need to be particularly resourceful in identifying ways of sustaining needed investments in areas where capital requirements are substantial and payback times are long, like transport and communications infrastructures. This section will review three capacities that have been identified as important to ensure adequate resources for public investment projects: multi-year budgeting, tapping traditional and innovative sources of financing, and involving private funds.

Capacity 6: Multi-year budgeting

Budgeting is the critical link between plans and resources. It is crucial that public investment plans be accurately costed for the intended investment period, and that those costs be reflected in the sub-national government’s budget strategy and allocation process. The absence of discipline around costing and budgeting undermines a government’s capacity to properly prioritise its investment programme, and can lead to chronic underfunding of individual investment projects. Fitting public investment plans into a medium-term budget framework helps provide visibility regarding resource availability and predictability (Rajaram et al, 2010; World Bank, 2009), particularly for long-term projects which may need to survive changes of government. Multi-year budgeting requires *inter alia*, stable, predictable revenue streams and expenditure obligations, which may depend on the national budget system. In the U.S., most states use some form of biennial budgeting which establishes revenues and expenditures for two years, and local governments often use multi-annual projections as part of

the budgeting process (Boex et al, 1998). In the EU the 7-year programming cycle of Structural and Cohesion funds has been a major incentive for EU regions to move to more multi-year budgeting. Among surveyed regions, investment expenditures are planned over a multi-year period in the regional annual budget.

Operating and maintenance costs of public investment should be duly considered during the planning and budgeting stages. As noted earlier, for many OECD countries with well-developed infrastructure, operating and maintenance costs represent a critical component of public investment – which often tends to be underestimated. Integrating an accurate assessment of recurrent costs into budget planning is therefore crucial. As Rajaram et al (2010: 8) note, “The key to efficient investment is both good decisions in choice of investments, and active management of the asset portfolio (including through disposals) and a budgetary process that ensures recurrent funding to operate and maintain existing assets.”

Capacity 7: Traditional and innovative financing

Sub-national governments need capacity to tap both traditional and innovative financing mechanisms for public investment. Traditional sources of financing - own revenue, intergovernmental transfers, and borrowing - will continue to be critical for sub-national governments. Own revenues are important for public investment not only to ensure the availability of resources but also because tapping own revenue is critical for certain types of investment. Kappeler et al (2012) find that “revenue decentralization, measured as the budget share of locally-generated tax revenues”, encourages regional governments to spend more on growth-enhancing (economic) infrastructure as compared to redistributive (social) infrastructure – an incentive seemingly weakened by capital grants. Own revenue is also frequently critical for meeting co-financing requirements to access intergovernmental grants.

Intergovernmental transfers are an important source of fiscal capacity for public investment, but tapping them frequently requires sufficient administrative capacity. As noted above, intergovernmental transfers represent an important source of financing for public investment. Accessing such grants can require substantial administrative capacity of sub-national governments, potentially leaving some of the neediest governments least able to access funds. Applying to EU projects, for example, can be particularly burdensome at the sub-national level. Many local governments consider not putting forward project proposals for this reason. Hall (2008) finds small, rural U.S. counties have notably less capacity to leverage federal grant funds (and suggests recourse to regional economic development organisations can enhance this capacity). Administrative capacity challenges also emerged in the context of the 2009 American Recovery and Reinvestment Act: distressed areas and small municipalities were less able to apply to relevant programmes and absorb the funding in the relevant timeframe, due to lack of capacities (OECD, 2011a).

Sub-national fiscal capacity can also be enhanced through borrowing, although borrowing may be constrained by fiscal rules. Borrowing capacity depends on many factors. Crucially, sub-national borrowing is often subject to constraints imposed by higher levels of government. Such constraints range from prohibition (e.g. Denmark and Korea) to no restriction at all. In most cases, sub-national borrowing requires prior approval by higher levels of government, and is often restricted to certain purposes (such as investment, “the golden rule”) (Charbit and Michalun, 2009).¹¹ Other factors affecting borrowing, particularly for accessing private credit markets, include a SNG’s own fiscal strengths and weaknesses, the country where it is located (i.e. the general economic situation, the sovereign credit rating), and the general health of banks and the financial sector. Presently, even fiscally sound, top-rated SNGs encounter difficulty getting bank loans because of the weak state of the banking system in a

11. The “Golden Rule” aims to encourage public investment while maintaining fiscal and debt sustainability. It is, however, subject to criticism. For discussion, see UCTAD (2009: 12-14).

number of countries (e.g. Spain among others). In Europe, outstanding debt in the form of (mostly long-term) bonds has increased in recent years, rising from 12.9% of sub-national public sector debt in 2000 to 31.3% in 2011 – with the greatest volume increases coming from regions in federal or quasi-federal countries. Local authorities, by contrast, have tended to rely more on loans (Dexia, 2012).

Unfortunately, tapping traditional financing mechanisms for public investment is currently a major challenge in some OECD regions. For surveyed regions, the most important difficulties relate to a reduction in revenues from (regional) taxes and central government grants. In the EU, fiscal consolidation efforts have led a number of countries to freeze or to reduce intergovernmental transfers for investment and capital operating expenditures – having a direct negative effect on investment in countries such as Spain, Greece, Slovenia, and the Czech Republic. Other countries maintained or expanded investment grants, such as Estonia, Poland, Germany and Finland. Austerity measures within Europe have also led to stricter fiscal rules, including changes to spending limits, budget deficit/surplus thresholds, and prudential rules regarding indebtedness (Dexia, 2012).

With fiscal tightening occurring on the revenue side, SNGs may look to create fiscal space on the expenditure side. Practices such as performance-based budgeting and “strategic reviews” can help to identify savings and create more fiscal space to meet investment priorities. Such fiscal space may be limited, however, by significant, non-discretionary current spending obligations of SNGs.

Innovative solutions to finance investment are needed but their complexity may require capacities lacking for some governments. Sub-national governments can make the most of traditional instruments as well as newer forms of financing, such value-capture taxes or carbon financing for green investments, and the use of technologies to improve user fees.¹² Some traditional and (especially) newer financing instruments require specific capacities from SNGs to use them. An understanding of the pros and cons of different financing vehicles and what they require in terms of the local financial situation, risk management, transactions costs, and market or other disciplines is important.¹³ Thus, to some extent, new tools can open the door to new capacity challenges. A kind of vicious cycle is at risk, with the regions in greatest difficulty being least able to use these new financial instruments.

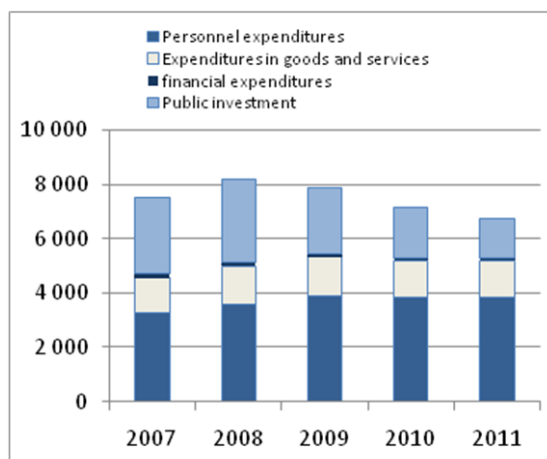
12. For example, see Wachs (2010) for a discussion of technology applied to road transportation user fees.

13. See Chan et al (2009) for a profile of the risk management, transactions costs, and exposure to market or other forms of discipline associated with major financing vehicles for infrastructure investment.

Box 5: Public investment as an adjustment variable: the case of Galicia (Spain)

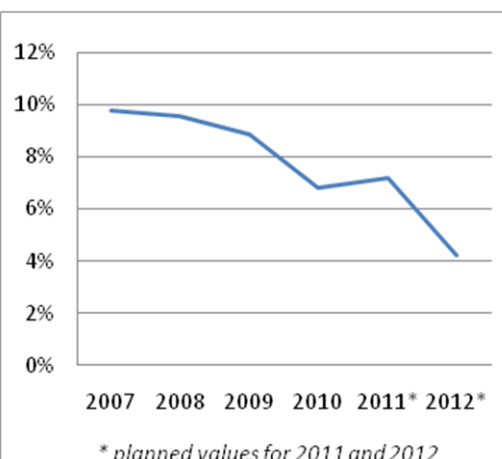
Galicia's financial capacity for investment has shrunk since the beginning of the crisis, due to the combined effect of a reduced current balance and a decline in capital transfers received. Facing a severe deterioration of public finances and increased expenditures in strategic sectors such as social protection, the regional government has used investments and transfers to local authorities and companies as adjustment variables in the context of fiscal austerity. Public investment as a share of total public expenditure has thus fallen sharply since 2007.

Repartition of major public expenditures in Galicia (millions of €)



Source: Region of Galicia, graphic excerpted from Hulbert (2012) (below).

Public investment as a share of total public expenditures in Galicia



Source: Galician Institute of Statistics, graphic excerpted from Hulbert (2012) (below).

Investment considerations are being made under notable fiscal constraints. In recent years the region has faced a significant fall in tax revenues, transfers from the central government have declined since 2010, and debt has risen - nearly doubling since 2007 to 12.8% of regional GDP in January 2012. (The recent increase in debt is unlikely to last due to central government efforts to limit regional debt.) Finally, EU funds presently account for a significant share (32%) of overall investment funding. However, in 2014 funds will likely decline as Galicia shifts from a "convergence region" (less than 75% of the EU average GDP per capita) to a "transition region" (between 75% and 90% of the EU average). At the same time, co-financing requirements are likely to increase.

Overall, the reduced financial capacity of Galicia's regional government for investment appears to be the main challenge to be faced in the years ahead. Steps are being taken, however, to improve the situation. First, in order to restore public finances, the Galician government plans a series of tax increases and improvements in tax collection between 2012 and 2014. In addition, in order to face the future decline in EU funds, in 2009 the Fundación Galicia Europa launched "the Convergence Regions on the Way to Cohesion" initiative. Along with other regions also exiting the convergence status, they requested the creation of a "safety net" for 2014-2020 consisting of an endowment equal to 75% of the Structural Funds received over the 2007-2013 period. This request is under discussion at the European level. Continued attention will also be given to increasing investment efficiency through improved technical capabilities and achieving economies of scale.

Source: Hulbert, C. (2012) "Public Investment across Levels of Government: The case of Galicia, Spain", report for the 28th OECD Territorial Development Policy Committee, 4-5 Dec 2012, available online at www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm and in summary form in OECD (forthcoming), *Investing Together Across Levels of Government: Meeting the Coordination and Capacity Challenges*, OECD Publishing.

Capacity 8: Private sector financing

While public sector financing is expected to remain a centrepiece of public investment efforts (OECD, 2008a), the need for private financing is undeniable (WEF, 2010). **The capacity to understand, secure, and maximize the value of private financing is thus integral.** However, private financing is not appropriate for all types of public investment. **Sub-national governments therefore need the capacity to assess the worth of and the best approach to private sector involvement.** Private sector participation should be undertaken after careful consideration of alternative modes of financing and delivery, and risk allocation should be based on an assessment of the public interest. This includes the capacity to demonstrate that public-private partnerships, for example, provide greater benefit than purely public investment (World Bank, 2009).

Despite the potential benefits, OECD questionnaire data suggest that private sector involvement in sub-national public investment remains relatively limited. The lack of involvement of private actors in public investment projects is recognised as a challenge by most case study regions and by 15 national governments. Difficulties may arise, in part, from the financial constraints currently facing potential private sector partners, as well as the limited capacity of some sub-national actors to evaluate the role of and engage the private sector. Sub-national governments can consider a number of important factors when crafting an environment conducive to attracting private financing. These include clear investment policy, transparent and competitive procurement policy, a pipeline of opportunities, a well-crafted regulatory environment, pathfinder projects, sizeable opportunities, credible project timetables, political support, and sufficient administrative capacity (WEF, 2010).¹⁴

Public-private partnerships represent one important approach to involving private financing, although their potential contribution extends beyond financing alone. Public-private partnerships (PPPs) are long-term contractual agreements between private actors and a public entity used to finance investment, share risk, and improve the efficiency of investment. The varying types of PPPs differ in the roles and responsibilities of public and private partners, ranging from Build-Transfer models (where the public sector retains responsibility) to divestiture, where the government transfers all or part of an asset to the private sector. Hybrid models have also emerged in response to challenges faced in different sectors. (Deloitte Research, 2007) Different forms of PPPs can have different financial implications for government and consumers. Thus, decisions regarding PPPs should be co-ordinated with the budget process and be consistent with an overall policy regarding the types of investment best undertaken via the public budget, through PPPs, and through purely private investment (World Bank, 2009).

PPPs can be particularly complex and sub-national governments may fall short of the technical capacities needed to assess, design and manage them. In fact, the weak capabilities of SNGs to manage PPPs have been highlighted as a challenge by 14 countries in the OECD national questionnaire. There is substantial complexity associated with all stages of PPPs, from ex-ante appraisal to management of risk to renegotiation. Some OECD countries have differing legal and regulatory frameworks for PPPs at different levels of government (Burger and Hawkesworth, 2011). Not all projects are best implemented via PPPs, and the capacity to assess value-for-money of various modalities is critical. Moreover, failure to treat PPPs properly in the budget process, disclosing all costs and contingent liabilities, exposes governments to financial risk. Bench learning, targeted training, creation of dedicated PPP units, and promulgation of good practices can strengthen sub-national capacities. Support can come from higher levels of government, as in the case of Canada where the federal government encourages the use of PPPs

14. See also the OECD (2007) Principles for Private Sector Participation in Infrastructure and the OECD (2006) Policy Framework for Investment. Although these target national governments, they can also provide insights for sub-national governments, particularly those with high levels of regional autonomy and those particularly exposed to international investment.

through PPP Canada, which incorporates, among other measures, the CAN 1.2 billion “P3 Canada Fund”, offering funding for PPP projects undertaken by provinces, territories and local governments.

Box 6: Good practices and challenges with using PPPs in three regions

State of Victoria (Australia)

Victoria has been a pioneer in PPPs, and its processes have been a model for the Commonwealth and for other states. Since 2000, when PPPs began in Victoria, they have comprised approximately 10% of infrastructure investment. There are now 22 PPP projects representing a total investment of AUD 11.5 billion. The Department of Treasury and Finance has established a unit called Partnerships Victoria as a source of standards guidance and policy development. A feature of the PPP business case development process is the requirement in each project to establish a “Public Sector Comparator” (PSC) – an independently verified cost estimation of the project assuming conventional contracting. The PSC then serves as a benchmark for assessing the value for money of the PPP proposal. Over the past ten years government departments have had to acquire a deeper understanding of the private sector in each area in order to better calibrate the contract incentives.

The Victorian government policy and philosophy around PPPs are in the public domain. This provides transparency to the private sector on the objectives, policies and processes for the application of PPPs, broadens market confidence and reduces the time and cost associated with private sector engagement. The government has noted, however, that as PPP contracts are output-based, identifying the appropriate output measures and performance levels is a substantial challenge. Additionally, the public interest generated by some of the more complex PPP projects in the water sector, such as the construction of a desalination facility to secure Melbourne’s water supply in the event of continuous prolonged drought, has also required the management of significant political risk.

Wielkopolska (Poland)

SMEs in the region of in Wielkopolska are keen to take advantage of the funding offered as part of EU programmes (as of April 2012, 1208 projects by SMEs were funded under ROP measures). However, in the vast majority of the cases they acquire funds for projects they implement themselves. Projects implemented in public-private partnerships (PPP) remain rare. In fact, PPPs have been a challenge in Poland due to lack of an adequate legal framework and low levels of trust between public and private sectors. Some examples do exist, however. One example is the “Galeria Goplana” project, which is being funded as a PPP. It involves the revitalisation of a decaying post-industrial area in the centre of Leszno with the aim of converting it into a commercial centre. The private investor will make one of the revitalised buildings available to the municipality, free of charge, for the establishment of a public multimedia library or tourist information centre. The total value of the project is PLN 178 million, while the loan amounts to PLN 50 million. Another example is support for a reconversion of a post-industrial building into an office space (Office Centre “Podwale” in Poznań). The private investor will offer venues for free training courses and workshops for the local community. The value of the investment amounts to PLN 30 million, while the loan offered by the UDF amounts to PLN 22.5 million.

Galicia (Spain)

Public-private partnerships (PPPs) in Galicia are relatively limited, having only been used so far for large-scale projects. Currently, two PPP projects are implemented and three are operational. The financial crisis has made PPPs more difficult to launch because access to funding by private companies has become complicated and more expensive. Galicia recently made two calls for tender but was unable to find companies with which to contract. No other PPPs are planned for the moment.

Sources: Excerpted with slight modification from Bounds, G. (2012) “Public Investment across Levels of Government: The case of Victoria, Australia”; Dabrowski, M. and Allain-Dupré, D. (2012), “Public Investment across Levels of Government: The case of Wielkopolska, Poland”; and Hulbert, C. (2012), “Public Investment across Levels of Government: The case of Galicia, Spain”, reports for the 28th OECD Territorial Development Policy Committee, 4-5 Dec 2012, online at www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm and in summary form in OECD (forthcoming), *Investing Together Across Levels of Government: Meeting the Coordination and Capacity Challenges*, OECD Publishing.

Encouraging accountability for public resources

Accountability for the use of public resources is a core responsibility at all levels of government. With approximately two-thirds of public investment occurring at the sub-national level, local and regional governments need adequate capacity to prevent waste, fraud, and mismanagement of these funds. Weak capacity and corrupt practices in this area can reduce trust, deter external investment, increase the costs of borrowing and investment, and potentially compromise quality. A variety of policies can be put into place to bolster accountability and control, and in many cases a higher level of government has an important role to play (discussed in a later section). The focus here is on the importance of sound procurement processes. Such processes matter enormously, because procurement is both critical for public investment and yet also the “government activity most vulnerable to waste, fraud and corruption” (OECD, n.d.).

Capacity 9: Transparent, competitive public procurement

Particular attention should be given to integrity in public procurement, with a focus on competitive and transparent processes.¹⁵ Good practices should exist throughout the procurement cycle – from the project design through the contract award until the contract management. Not only is proper procurement integral to sound investment management, but comprehensible and transparent procurement processes, conducted in a timely and efficient manner, are an important factor for attracting private finance (WEF, 2010). Unfortunately, procurement can be a weak area in the investment process. For example, the principal errors for EU funds absorption are associated with public procurement (41% of cumulative quantifiable errors in 2006-2009) and they are concentrated in a relatively small number of (regional) programmes in a limited number of Member States (EC, 2011c). (This underscores the place-based dimension of capacity challenges.)

The integrity of procurement processes is likely to be particularly critical in fields where capital expenditure constitutes a large share of spending. Capital-intensive public works tend to be particularly prone to corruption and abuse in many countries, because they involve industries with a limited number of potential participants, a limited number of licenses and detailed specifications for the participants (OECD, 2007d). Moreover, public officials may be unable (or have little incentive) to specify in advance all the elements of the goods and services to be supplied, as large projects can be difficult to define in advance and may require significant scope for adaptations as the project develops. The more complex the investment and the more it relies on one-off expenditure on complex goods and services, the greater is the difficulty in monitoring procurement. Other sectors characterised by large informational asymmetries between procurers and suppliers include healthcare/pharmaceuticals and ICT.

Weak procurement capacity can be an obstacle to effective public investment. Public procurement can be more challenging in small regions/municipalities with no specific office in charge of procurement or a lack of trained officials for procurement issues. It can be particularly problematic for sub-national governments with weak internal control systems, due in some cases to decentralisation that has outpaced improvements in administrative capacity. Four study regions indicate that procurement capacity presents a major impediment to effective public investment. They highlight obstacles to procurement as well: three point to an excess of administrative procedures (see Wielkopolska, Box 7), two note time constraints to be problematic, and one underscored the obstacle posed by overly restrictive bid specifications, creating red tape.

15. For example, procurement indicators are included in the Public Investment Management Index developed by Dabla-Norris et al (2011).

Box 7: Public procurement challenges in Wielkopolska, Poland

Public procurement is a challenge for the implementation of the Regional Operational Programme (the regional strategy with all co-funded investment projects) in Wielkopolska. A first problem identified is the instability of the legal framework for procurement, which has changed repeatedly in recent years. These frequent changes forced investors to adjust their ways of doing things and generated additional costs. A second problem concerns the auditors assessing procurement procedures. Officials in the region argue that the auditors impose serious sanctions for even minor irregularities in tenders and that these irregularities may be qualified as such, or not, depending on the interpretation of the individual auditor. This perceived inconsistency creates a climate of insecurity and mistrust, which makes the investors undergo increased efforts to assess minor details of projects and hinders smooth organisation of tenders. Control procedures implemented by the Polish auditors are stricter than those conducted at a later stage by EU auditors. Some respondents to the OECD questionnaire cited further obstacles to effective public procurement procedures, namely red tape, restrictive tender specifications and limited know-how on the organisation of tenders.

Source: Excerpted with slight modification from Dabrowski, M. and Allain-Dupre, D. (2012), "Public Investment across Levels of Government: The case of Wielkopolska, Poland", report for the 28th OECD Territorial Development Policy Committee, 4-5 Dec 2012, available online at www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm and in summary form in OECD (forthcoming), *Investing Together Across Levels of Government: Meeting the Co-ordination and Capacity Challenges*, OECD Publishing.

Good practices in procurement should exist at the national and local levels, as well as across sectors. Higher levels of government, which often set the regulatory framework for public procurement, play a leading role in ensuring the quality of sub-national procurement systems. Where sub-national governments have authority to design all or part of their procurement system, they too should seek to abide by good practice. The procurement systems should be transparent throughout the procurement cycle; competitive, with measures taken to enhance integrity if exceptions to competitive processes are made; and monitored to ensure funds are used as intended and complaints can be registered and addressed. Good practice also includes co-operation with the business and non-profit sectors to solicit feedback regarding procurement standards and their application, as well as to ensure their awareness of the consequences of non-compliance (OECD, 2008b). Collaborative procurement across levels of government as well as at the regional level can also help improve procurement capacity (e.g. purchasing alliances, networks, framework agreements as well as central purchasing bodies).

Initiatives to improve procurement occur at both the national and sub-national levels. At the national level, several OECD countries have recently changed their procurement legislation to simplify procedures or improve value for money. Portugal has for instance introduced in 2008 a new Code of Public Contracts which integrates dispersed regulations regarding public procurement. Slovenia has simplified procurement procedures and increased technical assistance to municipalities. At the regional level, Galicia has developed a web platform for public procurement procedures for all public entities, including municipalities. The goal is to integrate all public entities and private companies in a one-stop-shop for public procurement. In fact, regions surveyed consider that sharing information on procurement through web sites is one of the most effective practices to improve public procurement.

Promoting results and learning

Monitoring and evaluation processes play a crucial role in improving the efficiency and effectiveness of public investment for regional development. Well-designed monitoring activities allow actors to follow the implementation of investment projects and the achievement of contractual obligations, to encourage performance, to make mid-course adjustments, and to identify medium-term outcomes. Evaluation can identify impacts and provide useful information for future investment decisions. Both activities are critical mechanisms for accountability and learning: for transferring knowledge among parties and for improving performance by integrating feedback during and between investment cycles. A handful of

specific capabilities can enhance the value of monitoring and evaluation systems for sub-national governments.

*Capacity 10: Sound monitoring systems*¹⁶

A first critical capacity for effective monitoring of sub-national public investment activities is a well-designed monitoring system with a limited number of indicators which link to development goals. The monitoring system should contribute to credible and timely reporting of expenditure and performance. Deficiencies in this area can contribute to unsuccessful public investment management. Indicators should be relevant (linked to national and regional objectives), valid (measure the constructs of interest), reliable, and useful (provide actionable information for administrators and policy makers). A monitoring system for public investment has the potential to be unwieldy, and as a result time-consuming and costly to manage. It is therefore important to underscore the value of a focused set of indicators that provide actionable information. Information needs must be prioritised.

Because the investment mix should vary across regions, the indicators monitored should also vary, reflecting policy choices, goals, and programming decisions. The need to aggregate and compare data horizontally at different levels of government can be facilitated by encouraging local and regional actors to tailor their monitoring activities to their investment mix, but to do so by choosing from a menu of indicators with standardized definitions and requiring a common core set of indicators. To strengthen the understanding of and commitment to monitoring, the menu of indicators should be jointly developed by the local, regional, national and supranational actors that will report, monitor, and use the results of the indicator system. The final selection of indicators should include input, output, and outcome measures. There is a general trend to focus on final outcomes (results), with greater accountability placed on achieving results and greater flexibility given to sub-national governments to determine the means to achieve those ends. However, because regional development policy outcomes often occur with a lag of three, five, or more years into the future, output and intermediate outcome indicators should not be neglected. It is beyond the scope of this report to identify relevant indicators for different categories of investment; recommendations and examples can be found elsewhere.¹⁷

Designing and managing a results-oriented investment portfolio requires sub-national governments to set performance targets.¹⁸ This involves identifying which indicators should be associated with targets, establishing baseline values, setting targets, establishing the time-frame for measurement and reporting, and determining how accountability for achieving targets will be enforced – with an eye to minimising distortions created by performance systems. Some of the least distortionary targets can be attached to process indicators to ensure that investment projects are delivered according to contractual obligations (on-time, on-budget, in compliance with relevant regulations, etc.).

Critical to effective planning, as well as monitoring and evaluation, is the availability of good data throughout the investment cycle. Sub-national governments need comprehensive, accurate, robust, and timely data for effective monitoring and evaluation, as well as to support planning and ex-ante assessment of public investment. Because the scope of investments for regional development is broad – spanning multiple sectors and different levels of government – data needs are likewise comprehensive. Data are needed for determining investment *needs*, examining the *context* in which investment will occur, calculating the *benefits and costs* of investments as part of ex-ante assessment and selection processes, monitoring the

16. For an in-depth discussion of indicator systems for regional development policy, see OECD (2009a).

17. See, for example, OECD (2009a) as well as Barca and McCann (2011a, 2011b, and 2011c). An in-depth discussion of performance indicators for transportation PPPs can be found in Garvin et al (2011).

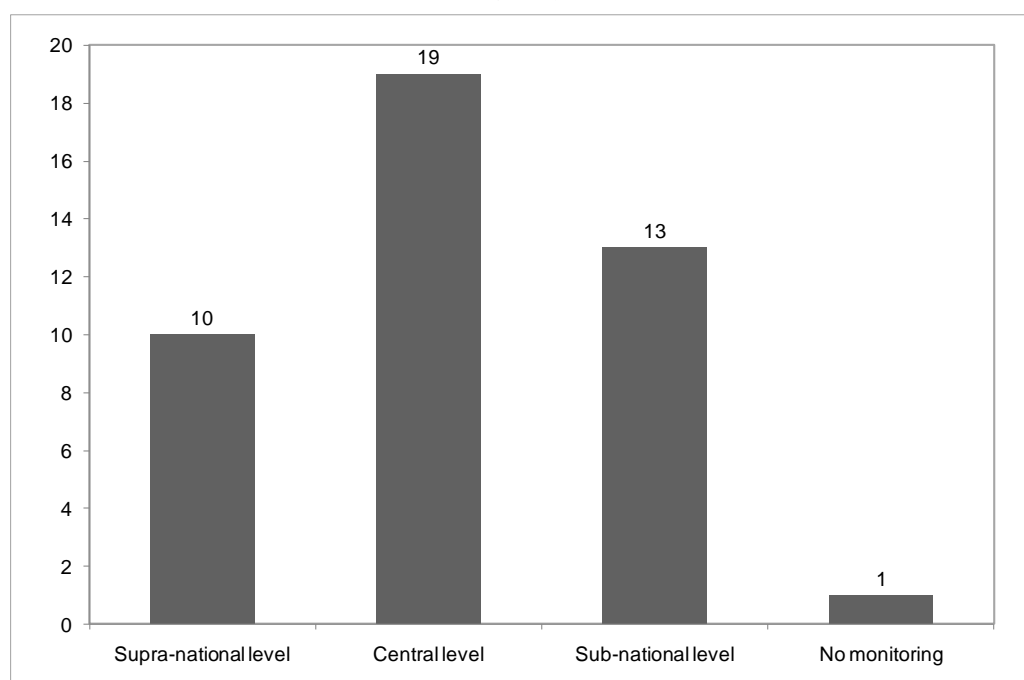
18. For a discussion of the major considerations for target-setting, see OECD (2009a), pp. 43-45.

implementation progress of projects and programmes in terms of *inputs, activities, and outputs*; and evaluating the achievement of intermediate and final *outcomes* that accrue to investments and their alignment with strategic development goals. Information regarding citizens' (and firms') preferences and feedback on future or past investment activities is also important for the purposes of accountability and planning.

Results of the OECD questionnaires reveal that monitoring is relatively standard in OECD countries for ensuring the success of an investment project. All but one country surveyed reported conducting performance monitoring of sub-national public investment by the central government level (generally by sector), with a majority also indicating that monitoring occurs sub-nationally (Figure 5). This includes the use of performance indicators as well as the formulation of objectives defined in the form of target values. Among case study regions, many carry out regular performance monitoring for public investment projects. Almost half use sanctions or rewards to encourage achievement of targets.

Figure 5: Levels of government monitoring public investment

(n=20)



Source: OECD national questionnaire on multi-level governance of public investment, 2012.

Capacity 11: Ex-post performance assessment

Just as strategic planning is crucial at the outset of the investment cycle, ex-post evaluation is crucial at the end. Review and assessment are essential following the completion of public investment projects. Dabla Norris et al (2011) underscore the importance of performance audit and evaluation.¹⁹ While both are critical for the purposes of accountability and learning, attention here is given to the latter. Ex-post evaluation can provide important insights to policy makers regarding the impacts (“results”) of investment choices, their contributions to economic development, and where breakdowns (or synergies) occurred. Done well, such evaluations allow policymakers to verify the achievement of anticipated outcomes

19. There is some overlap between performance auditing and ex-post evaluation in the type of information each can provide, although they generally have different purposes and are carried out by different entities (OECD, 2009e).

while learning how to improve the quality of investment decisions in a subsequent step. Sub-national governments need not conduct ex-post evaluations in-house, but should have access to independent bodies (e.g. research organisations, universities, consultancies) with the capacity to conduct high-quality evaluations under contract. While many of the surveyed regions indicate that they conduct performance evaluation, OECD national questionnaire data suggest that central governments perceive capacity challenges with respect to ex post assessment.²⁰ Thirteen countries (out of 18) consider the lack of ex post impact assessment for public investment projects as a challenge.

The challenges involved in ex-post evaluation depend to some extent on the sectors involved. It is critical that evaluations be linked as closely as possible to the goals of the investment, which may encompass some combination of growth (of output or employment) or service delivery (scale, effectiveness or efficiency). For example, where physical infrastructure is concerned, the challenge is to identify real economic impacts (in terms of traffic flows, impact on trade and commuting, etc), rather than – as is sometimes done – to assume that success is achieved if a given expansion of infrastructure provision is achieved on time and on budget. Investments in softer infrastructures (human capital, innovation systems) may be harder still to assess, since fairly sophisticated analysis may be needed to demonstrate “additionality” (i.e. the level of activity generated that would *not* have taken place if the investment had not been undertaken).

Capacity 12: Using performance information

Feedback mechanisms are important for monitoring and evaluation to have a positive impact on the quality of public investment. Well-defined indicators, properly established targets, timely reporting, and ex-post assessments will all be for naught if the information an M&E system produces goes unused. Learning happens in a repeated game, but only if information produced in a first step is used in a subsequent one. Critical then, is the capacity to use the information generated from these efforts in a productive way. Potential users of M&E information include programme administrators, policymakers at all levels of government, firms, and citizens. Importantly, the availability of information does not necessarily lead to productive use. Evidence should exist that performance information is both available to stakeholders and used in decision making.

As noted earlier, information provided to policy makers and administrators should “actionable.” **Policymakers and administrators at all levels of government should anticipate data needs, plan for their use, and seek to minimise the burden of data collection and reporting.** Too much information can overwhelm planning, monitoring, and evaluation processes, creating a substantial administrative burden and leaving much information unused. Information needs should be assessed early in the investment cycle, collection and use planned for, and reviewed and updated periodically (with a priority placed on introducing as few changes as seems reasonable).

One example of using performance information comes from Galicia, Spain – which introduced elements of performance budgeting into its 2011 budget process (Box 8). The primary objective is to use the outputs and outcomes achieved by the government sectors as an input for the negotiation process of the 2013 budget.

20. In some instances, higher levels of government may need to make ex-post assessment a requirement. As an example, little ex-post evaluation has been conducted of investment stimulus packages implemented in 2008-09 (OECD 2011a).

Box 8: Performance monitoring in Galicia (Spain) and Victoria (Australia)

The case of Galicia (Spain)

Some principles of performance budgeting were implemented by the regional government (without any demand or guidance from central government) during the 2011 budget process. The goal is to use the outputs and outcomes achieved by the government sectors as an input for the negotiation process of the 2013 budget. Indicators are being developed for all investment policies, and aim to improve budgetary management and efficiency, and identify inefficient expenditures in a context of crisis and fiscal austerity. To develop the system, the regional government drew on its experience with EU funds management. Galicia is one of the EU pilot regions using outputs and outcomes indicators as a central mechanism for management public investment funded by EU funds. The introduction of this approach was facilitated by the political environment created by the recent financial crisis and subsequent budgetary pressures. The regional government seeks to reorient the management of public investment from the expenditures side toward “results” (outputs and outcomes).

The case of Victoria, Australia

In Victoria, the bulk of assessment tends to occur prior to the commencement of the project. The focus of the new central quality assurance arrangements is on enhanced ex ante control - improving the business cases for major investments. These now require more effort and expertise by the Ministry responsible, and are subjected to rigorous scrutiny both at a technical level and in terms of their wider assumptions. (See previous discussion of The High Value High Risk process). The Business case process does however include the development of performance indicators and these are the basis for monitoring once the infrastructure is operational. Under the Victorian public service system, ex post evaluation of investment rests firstly with the ministry responsible. There are relatively few examples of such evaluation, and there has been criticism in some academic literature that PPPs in particular receive little evaluation.

Sources: Excerpted with slight modification from Hulbert, C. (2012), “Public Investment across Levels of Government: The case of Galicia, Spain”, and Bounds, G. (2012) “Public Investment across Levels of Government: The case of Victoria, Australia”, reports for the 28th OECD Territorial Development Policy Committee, 4-5 Dec 2012, available online at www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm and in summary form in OECD (forthcoming), *Investing Together Across Levels of Government: Meeting the Co-ordination and Capacity Challenges*, OECD Publishing.

Supporting all stages of the investment cycle

Some capacities are not unique to a single stage of the investment cycle but are highly relevant at each stage. Three such capacities are addressed here: 1) bolstering integrity, accountability and risk management, 2) engaging in “better regulation”, and 3) ensuring the availability of professional and technical skills needed throughout the cycle. Because policies for the first two generally involve higher levels of government, they are discussed further in the final section of the paper, with a brief discussion here regarding the role of sub-national governments. More attention is given to accessing and developing the necessary professional and technical skills needed to design and implement public investment programmes.

Capacity 13: Integrity, accountability, and risk management

Sub-national governments can enhance the integrity of the investment process by strengthening their capacity to identify and manage risks throughout the investment cycle. Risks to the quality and integrity of public investment planning and implementation exist throughout the investment cycle.²¹ There is a risk, at the planning stage for example, that the interests of certain stakeholders exert disproportionate influence in the orientation of investments. Regional and local governments thus need to identify the potential for and manage the risk of “capture” by specific interests. Stakeholder involvement poses different challenges in

21. For a discussion of types of investment risk in infrastructure, see Chan et al (2009: 15). This discussion relates largely to the profitability of investments. For a more comprehensive consideration of risks, see for example Provincial Government of British Columbia (Canada) (2002).

different types of regions, not least because much depends on how and to what extent non-state actors are organised and equipped for such a dialogue. The quality of public governance is thus linked to the quality of civil society and private-sector self-organisation. In some places, there may be difficulty identifying partners who represent a broad cross-section of society. In large cities the risk may be that very well-organised, well-resourced interests exert a disproportionate influence.

There are other risks as well. For example, in examining large infrastructure projects, **Flyvberg (2006, 2009) warns of “optimism bias” and “strategic misrepresentation” in planning which negatively affects public investment outcomes because costs and benefits are routinely inaccurately assessed, often to ensure project selection.** Moreover, he notes that mega-projects often experience a lock-in “of a certain project concept at an early stage, leaving analysis of alternatives weak or absent” and unplanned events with negative budgetary implications unaccounted for. The result is a selection of investments prone to cost overruns and/or fewer benefits than anticipated. He recommends the use of independent studies, reference class forecasting, ex-post risk analysis, as well as improved governance structures for independent oversight and competition, even going so far as to propose professional and criminal penalties for deliberate misrepresentation. (Flyvberg, 2006; Flyvberg, 2009; World Bank, 2009) An optimism bias may be more prevalent in “good times”, when funds abound and success seems possible, even for poorly planned projects.²² The UK has incorporated adjustment factors to account for an optimism bias, thereby improving the quality of net present value estimates (Laursen and Myers, 2009).

Corrupt procurement processes and fraud during the project implementation phase are other frequently identified risks for public investment. **Some risks are more subtle:** Consultation processes in which stakeholder inputs goes unused can lead to disenchantment and eventually reluctance to participate on behalf of important groups. Effective monitoring of the investment portfolio can be compromised by gaming and other strategic behaviours which lead to inaccurate data reporting. Poor quality ex-post evaluations can lead policy makers to believe greater results were achieved than in fact occurred, potentially skewing future investment decisions. Electoral cycles can also influence public investments, potentially leading to sub-optimal allocations (Sutherland et al, 2009). In short, there are a variety of risks which threaten to undermine the integrity of public investment planning and implementation, leading in turn to compromised accountability for the use of public resources. SNGs should be aware of, able to monitor, and able to mitigate these risks.

One approach sub-national governments can take to strengthen the quality of implementation is through regular review of their practices with ongoing attention to specific risks and “red flags”. Many of the good practices identified here can reduce the risks to integrity and accountability throughout the investment cycle. For example, rigorous ex-ante appraisal, well-managed stakeholder involvement, transparent procurement, sound monitoring and evaluation processes, and effective audit (see final section) all serve to increase accountability in the use of public funds. Assessing if and how to engage the private sector, as well as the robustness and sustainability of financing structures, can reveal risks that should be actively addressed (WEF, 2010). This can include using a public sector comparator (PSC) to evaluate the value-for-money of a PPP. A PSC “estimates the hypothetical risk-adjusted cost if a project were to be financed, owned and implemented by government” (Chan et al, 2009). (See Box 6 for an example of the use of the PSC in Australia.) Sub-national governments can consider a risk register (Laursen and Myers, 2009) which summarizes 1) important risks, their triggers, and their consequences that may arise at different stages of the investment cycle, 2) the

22. See, for example, “Spain’s white elephants in the room”, The Oliver Press, 13 Aug 2012.

seriousness of the risks, and 3) mitigation strategies that SNGs can take (Government of British Columbia, n.d.). SNGs should also ensure mechanisms exist to manage conflict of interest.²³

Capacity 14: Regulatory quality

Regulatory quality and coherence across levels of government play a critical role in sub-national public investment (Rodrigo and Allio, 2012). Because regional development policy involves multiple sectors and multiple levels of government, actors must deal with myriad institutions. Different types of obstacles to investment arise, such as overlapping/duplication/contradiction of regulations across levels of government and an increasing stock and flux of regulation which makes compliance difficult and costly. Regulatory coherence is often of particular importance in network sectors, like power, telecommunications and other utilities, owing to the greater degree of regulation to which such activities are typically subject. However, spatial planning and environmental regulation mean that even relatively basic public works projects may be impeded by a lack of regulatory clarity or coherence. For the private sector, a “lack of needed laws and regulations” or “a procurement process that doesn’t fit with existing laws and regulations” can deter investment, lead to delays, or even cause investors to abandon a project (WEF, 2010: 33, 36). In border regions, matters can become still more complicated, as even relatively minor differences in primary and secondary legislation can complicate cross-border investment co-operation (e.g. co-operation in healthcare between Skåne and Denmark’s capital region).

While the regulatory environment is not established by sub-national actors alone, their capacity for “better regulation” makes an important contribution to effective planning and implementation of public investment. In addition to minimizing unnecessary product market regulation at the sub-national level and increasing the transparency of sub-national regulations (de Mello, 2010), SNGs can put a number of good practices in place, including but not limited to: administrative burden reduction (with a focus on small- and medium-sized enterprises), ex-ante assessment of the costs and benefits of regulation (using tools such as Regulatory Impact Assessment, regulatory checklists, small business impact assessments, or deliberative committees), and formal consultation processes (such as informal inquiries, circulation of regulatory proposals for public comment, public notice and comment, hearings, and advisory bodies) (García Villarreal, 2010). A key point is to capitalise on the proximity of sub-national governments to local firms and citizens to better reflect local needs in overall regulatory policy. This can be done through e-government, for instance. In Austria, for example, most Länder have wide communication policies in place for existing regulations and draft regulations are accessible online (OECD, 2010b: 152)

23. For related guidance see the 2003 OECD Recommendation of the Council on Guidelines for Managing Conflict of Interest in the Public Service.

Box 9: Administrative capacity challenges for the EU Cohesion policy

For EU Cohesion Policy, the capacity of regions to spend the EU funding in a limited timeframe can be a critical obstacle to effective policy implementation. There is substantial variation across EU countries, from Romania which received 20% of available EU funds for the period 2007-2013 as of November 2011, to Portugal which received nearly 60%. In 2011, the European Parliament listed reasons for “absorption” problems. They include, among others:

- insufficient resources to co-finance projects;
- delays introducing EU & national rules or related guidance, and incomplete or unclear rules;
- overly complicated, overly strict, and frequently changing national procedures
- insufficient involvement of sub-national levels in establishing operational programmes;
- limited staff numbers, inadequately trained staff, and difficulties with staff retention;
- disproportion between the degree of control and the scale of the project; and
- insufficient preparation for implementation of projects, and missing project pipelines.

Sources: European Parliament (2011), “Report on absorption of Structural and Cohesion Funds: lessons learnt for the future cohesion policy of the EU”, (2010/2305(INI)), Plenary Sitting, A7-0287/2011, Brussels. European Commission (EC) (2012), “Percentage of funds allocated per MS paid by the Commission (08/11/2012)”, InfoRegio website, http://ec.europa.eu/regional_policy/thefunds/funding/index_en.cfm.

The capacity for “better regulation” differs across countries and sub-national governments. Few OECD countries have well-developed capacities for regulatory management at all levels of government (Rodrigo and Allio, 2012). Where the pace of decentralisation has outpaced growth in corresponding capacities, sub-national governments may find themselves ill-equipped for regulatory responsibilities. Likewise, a growing stock of regulations and frequent changes can make compliance a major challenge. Sub-national authorities with small administrations, especially in rural areas, often have adequate capacities to implement an increased number of regulations. In France, a 2011 report indicated that more than 55% of the articles of the *Code Général des Collectivités Territoriales* have been modified in less than 10 years. Inflationary regulation is estimated to have cost EUR 1 billion between 2009 and 2010 (French Senate, 2011).

Capacity 15: Professional and technical skills

Last, but far from least, there is a need for technically skilled public servants and/or access to technical capacity outside of government. Thus far discussion has emphasised sound policies and practices, and desirable outcomes from public investment planning at the sub-national level. Underlying this discussion, however, is a need for substantial professional and technical skills among public sector employees and organisations. Not least among these skills is the capability of individuals to consult, negotiate and co-ordinate with different levels of government²⁴ Case study regions report difficulties both attracting and retaining qualified staff. Region Skåne, for example, saw about one-third of its procurement department turnover in 2011 (Gamper, 2012b). Six regions indicate that offering salaries competitive with that of the private sector is a challenge.

24. The World Economic Forum (2010) highlights the need for: intelligent procurement, selecting transactions that represent best value for money, efficient decision making, and the ability to react to change.

Box 10: Investing in administrative capacity: Wielkopolska and Skåne

Wielkopolska, Poland

At the regional level, authorities have increasingly strengthened their administrative capacity to design and deliver regional development policy. The implementation of the EU funds has had a catalytic effect for enhancing administrative capacity at the regional level, particularly in 2007-2013. The number of staff dealing with regional policy increased from 12 to 250 in 2007, staff participated in training courses made available via EU Technical Assistance funds, and effort has been made to encourage an integrated approach to place-based development. Administrative capacity building is also part of the Regional Innovation Strategy for Wielkopolska 2010-2020.

At the local level, progress has been slower. Some municipalities have improved their capacity for strategic planning and effective design and management of investment projects. This was stimulated by no small measure by the desire to acquire EU funds, which requires project management skills, knowledge of the regulatory framework and a capacity to design strategies and projects to implement them. However, the financial capacities of many local authorities are limited. Many of them, including some of the better-resourced urban municipalities, opted to outsource tasks related to the preparation of investment projects and bids for funding to consultancies. In addition, local authorities face high staff turnover and struggle to attract skilled employees due to the low salaries on offer. Also problematic is the quality of training courses offered by firms and NGOs as part of projects funded from the European Social Fund. There is seldom a match between what is offered and officials' needs.

Skåne, Sweden

The 32 000 staff employed by the region benefit from a number of incentives to strengthen administrative capacity and performance. Region Skåne promotes mobility within the regional administration. It evaluates its employees' performance and rewards it by making parts of the salary dependent on performance. Challenges for Skåne do not lie in the ability to attract talent, but rather in keeping it. Region Skåne has benefited from an engaged workforce and has invested in them to become experts, for example in public procurement for health services. The challenge has been to retain staff after they have received a certain expert level, at which point they have become increasingly interesting for the private sector. As a consequence there is a significant staff turnover in the regional administration.

Sources: Excerpted with slight modification from Dabrowski, M. and Allain-Dupré, D. (2012), "Public Investment across Levels of Government: The case of Wielkopolska, Poland", and Gamper, C. (2012), "Public Investment across Levels of Government: The case of Skåne, Sweden", reports for the 28th OECD Territorial Development Policy Committee, 4-5 Dec 2012, available online at www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm and in summary form in OECD (forthcoming), *Investing Together Across Levels of Government: Meeting the Co-ordination and Capacity Challenges*, OECD Publishing.

Large regions, particularly established ones with substantial autonomy and significant numbers of staff, can tap a diverse range of professional skills. The same is not necessarily true for small regions, municipalities, newly created regions, or sub-national governments where decentralisation has outpaced corresponding growth in administrative capacity. Hall (2008: 111) notes, in reference to the U.S., that "insufficient economic development capacity is most prevalent in rural and small communities", with the "more rural the area, the wider the capacity gap in terms of financial resources, expertise, and professionalism." For these governments what is critical is not only their own capacity, but also their access to skills outside of the government. Assuring the *availability* of key capacities at relevant moments does not mean that each key capacity must be created and maintained by every governmental unit that might require it. Horizontal co-operation among SNGs, support from higher levels of government and recourse to the skills of universities, regional development agencies, and other outsiders are all ways of ensuring the presence of a capacity that a region or municipality may not need, or be able, to maintain on its own. Box 10 provides an overview of two regions' experiences investing in administrative capacity.

Sub-national governments can monitor workforce quality, strengthen HRM policies to encourage acquisition and retention of professional skills, and seek technical assistance where workforce gaps exist. In the current fiscal climate, with fiscal consolidation forcing a significant downsizing in public employment, it may be more difficult than ever for sub-national governments to attract and retain the talent they seek. Even in the presence of downsizing, however, monitoring the availability of skills for public investment management is useful, not only for determining what skills exist but also for identifying what skills need to be sought externally. Some indicators of in-house technical capacity are suggested as part of the diagnostic tool in the next section.

The importance of regional characteristics and category of investment

Thus far sub-national capacities have been discussed generally – but the path to growth differs among regions and capacity needs are not the same everywhere. Different types of public investment are needed in regions with differing characteristics. As a result, capacity needs will also vary. One cannot expect the same investment needs or capacities among urban and rural regions, large and small regions, those with substantial autonomy and those without, or among those with notably differing competences. Capacity is also likely to vary across sectoral policies. The remainder of this section provides some insights regarding the importance of institutional context, type of region, and sectoral focus.

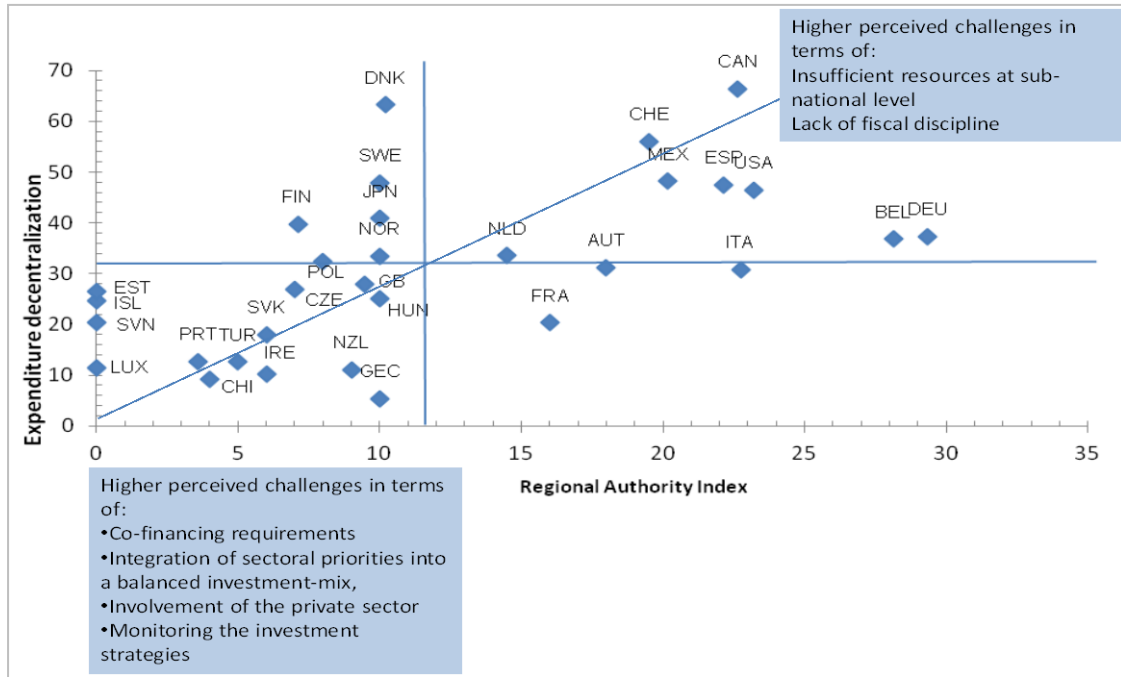
First, capacity challenges vary with institutional context. The importance of particular capacities and the challenges SNGs face are likely to vary across countries with differing distributions of competences related to investment, legal frameworks, and degrees and maturity of decentralisation. Where regions are not self-governing and/or regional authority over various aspects of the investment cycle is limited, capacities which rely on government authority are likely to exist at higher (or lower) levels of government. At the regional level, some capacity may be vested in an entity like a regional development agency, but with substantial capacity remaining at the central level. In these cases, planning-related capacities are often critical but others such as ex-ante appraisal, procurement, or monitoring may in fact be conducted (or led) by the central level. This is the case, for example, in the Skåne region of Sweden where strategic appraisal and financing of some investments (e.g. transport) are led by the central government (Gamper, 2012b). In some countries, weak (administrative) regions may have to confront a context of significant authority at the central level as well as at the municipal level, such as in Slovenia, where municipal mayors can have a strong impact on what happens in their region (OECD, 2011c). Finally, regions may be defined at a higher level than constitutionally defined ones (e.g. Canada) and given specific authorities, but in a context of significant sub-national autonomy. Each of these cases underscores the fact that any assessment of capacity needs to be preceded by a review of the assignment of competences related to public investment for regional development and an assessment of where real authority lies across the investment cycle. This is discussed in greater detail in the next section.

Exploratory analysis of responses to the national questionnaire suggests that some investment capacity challenges are prevalent in all types of regions, while others vary with the decentralisation context (Figure 6). Analysis of survey data suggests that co-financing requirements, the integration of sectoral priorities into a balanced investment-mix, the involvement of the private sector and monitoring the investment strategies are perceived by national governments to present greater challenges for sub-national authorities in countries where regional governments have little autonomy and where levels of fiscal decentralisation are low.²⁵ On the other hand, insufficient resources at sub-national level and lack of fiscal discipline

25. Regional authority is measured using the Regional Authority Index, a composite indicator measuring extent to which sub-national governments with an average population greater than 150 000 exercise formal authority. It measures regional authority in terms of two dimensions: self-rule and shared-rule. Self-rule is composed of (1) institutional depth (the extent to which a regional government is

are reported by national governments to be greater challenges in federal/regionalised countries. This is not to suggest that there is an optimal institutional design; constitutional structures reflect a complex mix of factors, of which fiscal efficiency is only one. Rather, it underscores the need to assess the decentralisation context in which public investment occurs in order to understand and address capacity challenges faced by SNGs.

Figure 6: Measures of decentralisation and sub-national capacity challenges



Notes: Data from (1) OECD Fiscal Decentralisation Indicators 2010 (data missing for Australia, data estimates for Chile based on DIPRES data), (2) Regional Authority Index from Hooghe, L., G. Marks and A. Schakel (2010), *The Rise of Regional Authority: A Comparative Study of 42 Democracies*, Routledge, London. Data from 2006 missing for Korea and Israel, data estimates for Chile and Mexico, and (3) OECD questionnaires on MLG of public investment (2012).

Challenges can also vary by type of region and level of development. While all regions need to identify an investment mix that addresses basic needs and capitalises on potential sources of growth, investment needs differ somewhat for regions depending on their density, economic structure and distance from the productivity frontier. For example, the leading urban regions tend to be well supplied in terms of physical infrastructure and focused on investments in hard and soft infrastructures to support knowledge creation. By contrast, regions further from the frontier often lag most in terms of human capital, while it is the intermediate regions that are most likely to run up against infrastructure constraints. Rural regions typically face particular challenges with respect to investments in education, health-care and other public services, where there is a need to ensure adequate access to rural dwellers without over-investing in facilities that are costly to build and maintain in the absence of economies of scale. The approach taken to strategic/capital planning for a large metropolitan area may therefore differ considerably from the approach taken in a small- to medium-size one. For cross-border regions, cross-jurisdictional

autonomous rather than deconcentrated); (2) policy scope (the range of policies for which a regional government is responsible); (3) fiscal autonomy (the extent to which a regional government can independently tax its population); and (4) representation (the extent to which a regional government is endowed with an independent legislature and executive). Shared-rule is composed of (1) law making (the extent to which regional representatives codetermine national legislation; (2) executive control (the extent to which a regional government codetermines national policy in intergovernmental meetings); (3) fiscal control (the extent to which regional representatives codetermine the distribution of national tax revenues); and (4) constitutional reform (the extent to which regional representatives codetermine constitutional change). (Hooghe, Marks, and Schakel, 2009: 334).

co-ordination capacity is critical. Moreover, the skills needed to identify and pursue opportunities for co-ordination are likely to differ when considering within-country cross-border investments as opposed to investments with international dimensions.

Finally, the importance of individual capacities differs across sectors. Large, complex multi-year investments are likely to require a sub-national government to tap a greater range and greater depth of technical skills over a longer period of time than a relatively short-term project. Large infrastructure projects are likely to be more demanding in terms of ex-ante appraisal, sophistication of financing arrangements, engagement of the private sector, monitoring and evaluation. For some SNGs, existing capacities may be more advanced for designing and delivering traditional infrastructure projects (and sectors that have long been a focus for regional development, such as transportation) than for innovation-oriented ones.

While it is beyond the scope of this paper to identify a weighted capacity mix for each type of region or category of investment, overall, the capacities described here are expected to benefit all types of regions. **Nevertheless, some capacities stand out as “critical capacities”: those that are likely to be valuable for the efficiency and effectiveness of public investment in almost every context.** Without these, the other capacities may lack a mature governance framework on which they can be built. SNGs with weak or underdeveloped capacities for public investment could place priority on these capacities. Indicated by a star in Table 1, they are:

- To engage in strategic planning that is tailored, results-oriented, realistic, forward-looking and coherent with national objectives;
- To conduct rigorous ex-ante appraisal;
- To tap traditional and innovative financing mechanisms for public investment;
- To engage in transparent, competitive, procurement processes with corresponding internal control systems;
- To design and use monitoring indicator systems with realistic, performance promoting targets; and
- To ensure the quality and availability of technical and managerial expertise necessary for planning and executing public investment.

Where sub-national governments, and regions in particular, have weak authority over key aspects of the public investment cycle and rely heavily on other levels of government to move a public investment portfolio forward, the capacity to consult, negotiate, and co-ordinate with other levels of government will be vital. This is all the more true for the critical capacities.

Conclusions

The preceding discussion has outlined capacities that can enhance sub-national governments’ efficiency and effectiveness with respect to public investment management for economic growth and public service delivery. The list is by no means exhaustive, but rather highlights capacities that can make a positive impact on the selection, implementation, and outcomes of sub-national public investment. It is important to underscore that different types of regions will have different capacity needs and differing arrangements to achieve them. Institutional context will play an important role in determining the depth of capacity that can reasonably be expected of sub-national governments. **What is crucial is that sub-national governments undertaking public investment pause to review the capacities discussed here (alone or in partnership with higher levels of government), identify gaps, and seek opportunities to strengthen their capabilities throughout the investment cycle.** The following two sections provide guidance in these areas.

Assessing sub-national capacity for public investment

The previous section identified 15 sub-national capacities that can enhance the efficiency and effectiveness of public investment. But, as established earlier, different regions have differing investment needs and face different types of challenges with respect to capacity. In some cases, capacity is largely “shared capacity” with other (often higher) levels of government. A sense of priority is needed regarding where primary weaknesses exist and which types of remedies might be applied in a given context. This section discusses the complexity of evaluating capacities and provides some guidance for doing so.

Identifying the major capacity gaps/failures that exist at various stages of the investment cycle can help establish priorities for improving investment in a particular region. Not all the capacities can be strengthened at the same time and some capacities may need to be strengthened before than others. It is therefore critical to identify binding constraints, appropriate remedies, and the proper sequence of reforms. “Binding” constraints are those weaknesses in one or more stages of the investment cycle that fundamentally constrain overall performance. The diagnosis should also identify which challenges are the responsibilities of SNGs alone (with various stakeholders in the region), which challenges are shared responsibilities with other levels of government, and which challenges are the responsibilities of the national government only. Thus, while all 15 capacities described here are important for sustained investment success, identifying the critical bottlenecks can help to differentiate SNGs from each other, to better calibrate investment strategies to sub-national challenges, risks, and current capacities, and to establish priorities for capacity development efforts.

Assessing the state of sub-national capacity for public investment can be a complex exercise, requiring substantial information from a variety of stakeholders. Such a diagnosis is a “big picture” analysis to guide the definition of priorities and the sequencing of public investment capacity development activities. Using the capacity framework provided here, it should examine the investment process, as well as the broader institutional environment in which investment is undertaken. This type of assessment cannot be conducted effectively on the basis of a few indicators; comprehensive information – both quantitative and qualitative – is needed to reveal and confirm where breakdowns occur. “Absorption capacity”, for example, is a commonly used indicator of capacity problems in EU countries. It measures the extent to which a Member State and its regions are able to spend the financial resources allocated from the Structural and Cohesion Funds in an efficient manner. While useful, it provides a partial view and signals the need to investigate further the underlying capacity problems (see Box 9).

Capacity assessment must begin with a clear understanding of where authority lies throughout the investment cycle. As underscored earlier, the decentralisation context in which sub-national public investment occurs affects what can be expected of sub-national governments. The greater the authority of regional governments throughout the investment cycle, the better developed their capacities must be. By contrast, where a higher level of government takes a leading role at different stages of the investment cycle (e.g. for ex-ante appraisal or procurement), the capacity of sub-national authorities to set the stage for, participate in, and use the results of these processes (e.g. through sound planning, effective negotiation, information sharing, or monitoring) can enhance governance.

Once the context for sub-national public investment has been established, Table 3 suggests a series of (self) assessment questions that regions (and other levels of government) can use to initiate a comprehensive review of their public investment capacities. The tool is designed to reveal which of the 15 capacities might need bolstering and which might be more mature. It is intended to be a broad diagnostic tool, generally applicable for regional development rather than for specific sectors. The goal is to provide a general indication of strengths and weaknesses, and thus be a starting point for further investigation and

for capacity development efforts. As Hall (2008) recommends, it raises questions regarding regions' internal capacity as well as sources of capacity external to the government.

Capacity assessment can be undertaken by regions themselves or jointly with a higher level of government. Engagement of SNGs in capacity assessment is critical for encouraging a nuanced assessment of the dynamics of investment in a place and for cultivating buy-in for any subsequent reforms or capacity development initiatives. A purely top-down approach to assessment and capacity development involves risks that underscore the value of sub-national involvement. Risks include, but are likely not limited to, inaccurate assessment of sub-national capacities devoid of context, incentives for sub-national governments to misrepresent capacities, formalistic compliance with “good practice” without real capacity development, the persistence of information gaps between levels of government due to a lack of trust, and a lack of simultaneous improvement of policies and practices at the higher level of government. These risks can be attenuated (even if not eliminated) by active engagement of sub-national governments in capacity assessment and development activities, in conjunction with establishing capacity-related performance targets.

Crucially, assessment should be seen as a learning exercise that reveals where strengths and weaknesses in public investment capacity exist, what might be reasonably expected in terms of contractual obligations in time period t , the role of different levels of government in strengthening capacity throughout the investment cycle, and what capacity enhancements might be targeted for period $t+1$. Both a sectoral view and a whole-of-government view are critical since cross-sectoral co-ordination and complementarities across investment priorities are fundamental for the place-based impact of public investment.

Seven of 20 countries responding to the OECD survey indicate that they have carried out assessments of variations in governance capacities across sub-national authorities in the past – although not necessarily specific to public investment. Estonia, for example, has carried out three studies (two of them are updates of previous studies) examining local governance capacities during the previous five years. These studies have incorporated indices to measure local governments' institutional capacity, financial capacity, and capacity for providing public services (as well as a composite index). Other countries have undertaken studies which capture dimensions of capacity in a broader context. In Sweden, the state agency “Growth Analysis” studied the contributions of municipalities and regions to regional growth initiatives in an effort to understand their capacities, priorities, and constraints (Tillväxtanalys, 2011). In 2007, the UK conducted its *Review of sub-national economic development and regeneration*. In Slovenia, municipal management capacity was the subject of academic study in 2008, drawing on a survey of municipal directors.

Conclusions

Capacity assessment for sub-national public investment is a complex exercise, made more challenging by the sharing of responsibilities among levels of government. Delineating the institutional context in which public investment occurs is a crucial first step in understanding what can be expected of sub-national actors. Understanding where authority lies throughout investment cycle is needed to temper what can be expected of sub-national actors, and what the “depth” of different capacities should be. With a solid understanding of the institutional context in mind, attention can be given to identifying “binding constraints” on the effectiveness of sub-national public investment management and exploring which sub-national capacities need strengthening.

Table 3: Sub-national capacities for public investment: assessment questions

CAPACITY	(SELF) ASSESSMENT QUESTIONS FOR SUB-NATIONAL GOVERNMENTS
To engage in planning for regional development that is tailored, results-oriented, realistic, forward-looking and coherent with national objectives	<ul style="list-style-type: none"> • Do mechanisms exist to ensure that sub-national investment plans reflect national and sub-national development goals? • Is there correspondence between territorial assessment, needs, and planned projects? • Is there a clear and authoritative statement of public investment priorities at national level? At the regional level? • What consideration is given to complementarities between investments in hard and soft infrastructure? • Do authorities assess the potential contribution of investments both to current competitiveness and to sustained growth in the global economy? • Are data available and used to support the territorial assessment and planning process?
To co-ordinate across sectors to achieve an integrated place-based approach	<ul style="list-style-type: none"> • Is attention given to potential complementarities and conflicts among sectoral investments? • Do formal or informal mechanisms exist to co-ordinate across sectors (and relevant departments/agencies) at the sub-national level?
To co-ordinate with other jurisdictions to promote complementarities and to achieve economies of scale across boundaries	<ul style="list-style-type: none"> • Have cross-jurisdictional partnerships involving investment been implemented previously? For specific sectors or all sectors? • Does a higher level of government require, support, or provide incentives for cross-jurisdictional co-ordination?
To involve stakeholders in planning to enhance the quality and support for investment choices – while preventing risks of capture by specific interests	<ul style="list-style-type: none"> • Do mechanisms exist to identify and involve stakeholders throughout the investment cycle? Which categories of stakeholders are most/least engaged? • Is a communication strategy for stakeholders in place? • Do citizens have access to timely information throughout the investment cycle? • Is stakeholder feedback incorporated into decision making? How?
To conduct rigorous ex-ante appraisal	<ul style="list-style-type: none"> • What percent of investment is subject to ex-ante assessment (by sector)? What is not covered? • Does the SNG have access to and use published guidance that details appraisal methods and standards? • Is there independent review of appraisals to ensure their objectivity and quality? • Is the SNG able to tap appropriate expertise, either in-house or elsewhere, to ensure proper technical appraisal of complex/sophisticated investments? • Are the results of ex-ante appraisals used to prioritise investments? • What percent of SNG staff has project evaluation skills? What percent of these staff are in positions that make use of their skills?
To link strategic plans to multi-annual budgets	<ul style="list-style-type: none"> • Are investments funded with a multi-year budget envelope? • Are the costs of operation and maintenance assessed on a long-term basis? • Is there a medium-term planning and budgeting framework? Is this framework integrated with the annual budget? • Are multi-year forecasts for public investment reviewed and updated regularly?
To tap traditional and innovative financing mechanisms for public investment	<ul style="list-style-type: none"> • What is the fiscal situation of SNGs? What are the main fiscal capacity challenges? • How are public investment projects financed? Are innovative mechanisms used? • Do SNGs have access to information concerning (supra) national funds for investment? • What challenges are encountered in accessing or using different sources of financing?
To mobilise private sector financing, without compromising long-term financial sustainability of public investment projects	<ul style="list-style-type: none"> • Is private sector engagement considered in conjunction with alternative modes of financing and/or delivery? • Has the SNG engaged in PPPs? In which sectors? Have problems been encountered? • Does a dedicated PPP unit exist that can assist sub-national governments?
To engage in transparent, competitive, procurement processes with corresponding internal control systems	<ul style="list-style-type: none"> • What percentage of total annual tender procedures is competitive? What percent is conducted online (e-procurement)? What percent is the subject of complaint? • What percentage of total annual contracts awarded go to SMEs? • What percentage of staff involved in procurement activities has related training? • Is formal guidance regarding procurement procedures provided to staff involved in procurement activities? • Is there a procurement unit that can assist SNGs?
To design and use monitoring indicator systems with realistic,	<ul style="list-style-type: none"> • Does a system of performance indicators exist? • Do monitoring systems facilitate credible and timely reporting of expenditure and

CAPACITY	(SELF) ASSESSMENT QUESTIONS FOR SUB-NATIONAL GOVERNMENTS
performance promoting targets	performance? <ul style="list-style-type: none"> • Does the indicator system incorporate output and outcome (results) indicators? • What percent of indicators are associated with targets?
To conduct regular and rigorous ex-post evaluation	<ul style="list-style-type: none"> • Is ex-post evaluation of investment projects required? • What share of public investment spending is subject to ex-post evaluation (by sector)? • Do clear guidance documents exist that detail ex-post evaluation standards?
To use monitoring and evaluation information to enhance decision making	<ul style="list-style-type: none"> • Does a dissemination strategy for monitoring and evaluation information exist—both for public reporting as well as internal use? • Is there alignment of the timing of budget preparation and the availability of monitoring and evaluation data? • Do policymakers incorporate performance information from previous periods into current decisions? • Are actors sanctioned or rewarded based on the achievement of targets? • Are data made available in a timely way and in a useable format for decision makers?
To monitor and manage risks to integrity and accountability throughout the investment cycle	<ul style="list-style-type: none"> • Are processes in place to identify, assess, and respond to risks throughout investment cycle (e.g. captured in a risk register)? • Are measures in place to address potential conflict of interest? • Are whistleblower protections available? • Does risk assessment have a bearing on project selection or management arrangements?
To engage in “better regulation” at sub-national levels, with coherence across levels of government	<ul style="list-style-type: none"> • Does the sub-national government have access to and participate in mechanisms for co-ordinating regulatory coherence across levels of government? • Is regulatory impact analysis used? • Are public consultations in connection with the preparation of new regulations of sufficient duration, accessible, and appropriately targeted? • Is there consistent consideration of alternatives to regulation? • Have there been efforts to reduce the stock of regulation or simplify administrative procedures in the past few years? • Are e-government tools used to simplify administrative procedures for public investment projects?
To ensure the quality and availability of technical and managerial expertise necessary for planning and executing public investment	<ul style="list-style-type: none"> • What percent of employees work on public investment tasks (% FTE)? What percent of these have had formal training in a related area, such as ex-ante appraisal? • Does a formal process for training staff in technical skills for public investment exist? What are training utilisation rates? • Are professionals/new hires available from university programs that provide training related to public investment (e.g. urban planning, regional policy, public policy, economics, etc.)? • Is the performance of agencies/departments/units dealing with sectoral and regional public investment regularly monitored and assessed? Are there specific rewards and sections? • Is the performance of public employees dealing with public investment projects regularly assessed? • Is external technical assistance (e.g. for planning, ex-ante assessment, ex-post evaluation) readily available – such as through regional development organisations, universities, think tanks, or independent consultants?

Sources: Authors' elaboration, plus Dabla-Norris, E. et al (2011), "Investing in Public Investment: An Index of Public Investment Efficiency", *IMF Working Paper 11/37*; Milio, S. (2007), "Can administrative capacity explain differences in implantation performances?", *Regional Studies*, Vol. 41, No. 4, pp. 429-442; Rajaram, A. et al. (2010), "Framework for Reviewing Public Investment Efficiency", World Bank Policy Working Paper, No. 5397 (August), 17, Washington, DC; OECD (2012), "Progress Made in Implementing the OECD Recommendation on Enhancing Integrity in Public Procurement".

Strengthening sub-national capacity for public investment

Capacity building for sub-national public investment goes beyond a narrow approach focused on workforce improvement activities. In this paper, capacities have been defined in terms of the institutional arrangements, technical capabilities, resources and policy practices that affect public investment. Thus, a narrow approach to training is unlikely to have the desired, institution-strengthening impact. Capacity development can have the short-term goal of improving specific practices, but should have the long-term objective of improving the quality of key government institutions. For this reason, a systemic perspective is needed that embraces the nature and quality of the institutions involved at all levels of government, as well as relevant parts of the private sector. The remainder of this section provides an overview of practices that all levels of government can employ to strengthen capacities for sub-national public investment.

Developing capacity in the context of vertical relations

The interdependencies among actors at different levels of government that arise in designing and implementing public investment for regional economic growth are inevitable and often result in a situation of shared capacity. Capacity development mechanisms are therefore needed that acknowledge and bolster these relationships. **One approach to capacity building thus explicitly involves relations between levels of government.** Associated mechanisms include (but are not limited to) contractual agreements among levels of government, intergovernmental transfers, intergovernmental fora, and technical assistance and training.

Contractual arrangements

Contractual arrangements are one approach to managing the intergovernmental obligations inherent in sub-national public investment activities. Such contracts “enjoy a degree of flexibility of use and diversity of application” that make them useful for clarifying responsibilities among parties, encouraging parties to perform efficiently, and supporting experimentation and learning (OECD, 2005; OECD 2007b; Charbit and Michalun, 2009).²⁷

Contractual arrangements can take account of relative capacity and incorporate sufficient scope for capacity development. There are many unknowns with respect to regional development and exogenous factors affect development outcomes. Planning and implementation capacities are also variable and should be taken into account when designing contractual arrangements. Where greater uncertainty exists and capacities are less developed, the contract is likely to be more “relational” than “transactional”.²⁸ Where sub-national capacities are found to be lacking, a higher level of government could consider assuming (at least temporarily) responsibility for some aspects of public investment, with a provision made for sub-national capacity development over time. Alternatively, in some cases, there may be a need for “learning by doing”, with sub-national governments undertaking lead roles in public investment (e.g. developing a public-private partnership) but receiving capacity support.

In some cases, both higher levels of government and sub-national governments may seek to innovate in particular areas, building new capacities and new approaches to

27. There are multiple examples of contractual arrangements for regional development in the OECD area (OECD, 2005; OECD, 2007b; OECD, 2011d) including the EU’s “Partnership Contracts” with member states for the 2014-2020 Structural Funds programming period. These new-generation contracts will set out agreement between the EU and its member states regarding the investment priorities for EU Structural and Cohesion funds, the allocation of resources, and the targets to be achieved (EC, 2012; Euractiv, 2011).

28. See OECD (2007b) for an in-depth discussion on the difference between relational and transactional contracts for regional development policy, as well as the contributions that different factors make to determining which approach best fits a particular situation.

investment. In such cases, it can be valuable to build flexibility into contractual arrangements. For example, pilot programmes which do not oblige all regions or municipalities to engage in a particular policy, practice, or institutional arrangement – but instead offer individual or groups of sub-national governments the opportunity to “learn by doing” on experimental basis can be one way of doing so. Successes and challenges encountered in pilot initiatives can be shared with other sub-national governments, used as the basis for a more formal/less experimental next step, provide learning opportunities, and build administrative capacity. (OECD, 2007b; Charbit and Michalun, 2009)

Intergovernmental transfers

As noted earlier, the fiscal capacity of sub-national governments is seen as a major challenge by both central and sub-central governments. **Appropriate funding and proper intergovernmental grant design can enhance fiscal capacity for public investment, while helping to align national and sub-national priorities.** A critical argument for decentralisation is that sub-national governments are better informed about their needs and better able to tailor the mix of investment and services to their region than higher levels of government. Thus, general purpose grants generally make sense to finance investment and permit allocation of resources to cost-effective programmes, albeit with some exceptions: 1) earmarked grants can direct sub-national investment to specific areas and encourage alignment with national goals, and 2) earmarking and matching requirements can encourage increased provision in the presence of positive spillovers (Bergvall et al, 2009) and the latter can encourage ownership of the financed activity. Attaching some conditions to monies can also be useful where sub-national capacity to identify cost-effective investments is weak, and/or there is a need to encourage cross-sectoral or cross-project synergies.²⁹

Earmarked and matching grants have limits, however. First, the extent of spillovers is difficult to quantify and easy to overestimate.³⁰ Second, extensive earmarking may unnecessarily “impede appropriate fungibility of resources and limit sub-national ability to deliver adapted policies” (Charbit, 2011). There is a risk, as Kappeler et al (2012: 3) note, that “the use of earmarked transfers might considerably reduce the autonomy that sub-central governments have on decisions regarding amount and composition of investments. Selecting investment projects based on complex hierarchical systems might in practice delink the decision to undertake a project in a given region from its growth effects – and thus tax revenues – in that particular region.” Thirdly, while co-financing can encourage local “ownership” of investment activities, thereby providing an incentive for self-assessment and capacity development, excessive co-financing requirements may make grants unattainable for regions or localities facing tight budget constraints. For these reasons, as well as the potentially negative effects central control can have on subsidiarity and democracy, earmarking and co-financing requirements should be well-thought through.

Intergovernmental co-ordination bodies

Effective horizontal and vertical co-ordination arrangements are not only a needed capacity for sub-national public investment, but also serve to strengthen other capacities.³¹

29. Posner (2009, pg. 11) asserts, “the current [U.S.] highway program resembles a devolved block grant where state and local governments set the goals with little accountability for performance for national goals and interests. Programs are stove piped by mode with little capacity to address multimodal interactions or projects. The United States is one of the few advanced economies without an integrated approach tying together aviation, rail, transit and roads in a cohesive framework. There are few levers to prompt the system to address such broader national concerns as climate change, energy conservation, interstate bottlenecks and other broader interests that transcend state boundaries.”

30 See Blöchliger, H. & O. Petzold (2009).

31 See Charbit and Michalun (2009) regarding the overlap between co-ordination and capacity building.

Among its other benefits, co-ordination between levels of government and across jurisdictions can strengthen capacity through information exchange, training, and showcasing good practices. In a vertical context, co-ordination bodies can act as platforms for clarifying capacity challenges and bottlenecks impeding effective management of sub-national public investment, for ensuring sub-national input into national policies, and for promoting an integrated, cross-sectoral perspective on public investment. In the OECD area, 13 countries (out of the 20 that have responded to the questionnaire) report they have a national body in charge of national/sub-national co-ordination; 10 countries report sub-national fora play a role in co-ordinating prioritisation/implementation of public investment between national and sub-national levels. In some cases, intergovernmental fora may not be specific to public investment, but may be a useful platform nonetheless. The Swiss Tripartite *Agglomerationskonferenz* (TAK) brings together the Confederation, cantons, cities/communes to facilitate development of joint agglomeration policy, information exchange, collaboration with agglomerations, and to address specific agglomeration problems (OECD, 2011d).

Effective co-ordination platforms are not just “talking shops”, but provide a platform for decision making as well as for discussion. In Canada, a Federal, Provincial and Territorial Working Group on Regulatory Reform was created as a forum to help build a shared approach to regulatory reform. Its work includes developing common regulatory principles, developing a consistent approach to regulatory impact analysis and sharing best practices. The aim of the group is to develop government capacity to produce quality regulation and encourage regulatory co-operation across jurisdictions. In Australia, the intergovernmental Council of Australian Governments (COAG) plays a vital role in implementing reforms and improving economic performance.³² Among numerous other achievements, through COAG, the federal and sub-national governments have endorsed national guidelines on public-private partnerships, agreed to a national port strategy, and concluded intergovernmental agreements on heavy vehicles, rail and maritime safety (COAG, n.d.; OECD, 2011a). According to COAG, recent “heavy vehicle regulator reforms alone are worth up to \$30 billion to the national economy over 20 years.” (COAG, 2011) COAG also receives regular reports from Infrastructure Australia, a statutory body established at the federal level to support nationwide infrastructure investment and to advise governments and other investment stakeholders (Infrastructure Australia, 2012).

Technical assistance and training

Where the higher level of government has greater expertise, access to resources, or perceives undeveloped capacity, it can support capacity building directly through a variety of activities, including technical assistance and training. Examples of (supra) national support for sub-national capacity for public investment exist throughout the OECD region. At the highest level, the EU provides financing through the European Social Fund for “strengthening the institutional and administrative capacity at local, regional or national levels in convergence regions and member states receiving cohesion funding. Activities include, for example, the modernisation of human resource management, reorganisation of roles and competences of public administration, fighting corruption, support to social partners and NGOs, reducing administrative burden of businesses, strengthening regional and local administrations, and modernisation of policy development processes” (EC, 2011b). A recent national example comes from the U.S. Strong Cities, Strong Communities initiative, launched with six pilot cities in 2011, brings together 19 federal agencies to strengthen the capacity of economically distressed cities to meet development goals (see Box 11).

32 COAG is composed of the Prime Minister, State and Territory Premiers and Chief Ministers, and the President of the Australian Local Government Association. Its role is to “initiate, develop and monitor the implementation of policy reforms that are of national significance and which require cooperative action by Australian governments” (COAG, 2013).

Box 11: The White House Council on Strong Cities, Strong Communities

The U.S. White House Council on Strong Cities, Strong Communities (SC2) is a cross-sectoral federal government initiative designed to strengthen the capacity of distressed cities to achieve economic development goals. It is intended to alter the way federal agencies work with local governments, cutting through red tape, reducing the time it takes to get things done “on the ground”, and seeking innovative ways to leverage limited federal funds. Launched with six pilot cities in 2011, the interagency Council brings together 19 federal agencies and offers four approaches to assisting local governments:

- *Community Solutions Teams* composed of employees from several federal agencies placed full- and part-time in the six pilot cities work directly with city staff on issues mayors have identified as vital to their economic development. Federal employees have decision authority, enabling them to cut through the red tape and to facilitate access to federal support.
- *A competitive fellowship program* for mid-career professionals to serve multi-year terms in local government positions in seven pilot cities to work with the Community Solutions Teams, bolstering local capacity. The pilot cities, which include Detroit and New Orleans, face chronic, acute economic development challenges. The fellowship is funded with support from the philanthropic Rockefeller Foundation.
- *The SC2 Challenge competitive grant program*, administered by the U.S. Economic Development Administration (EDA), will help six cities develop a high-quality economic development plan. These cities will invite expert teams to compete in a two-stage process to provide the city with a comprehensive innovative economic development plan. Each city will each receive USD 1 million to award for the strongest plans, as well as technical assistance and support from the EDA throughout the process. Cities themselves are selected via a competitive process; the first three were chosen in fall 2012 (Greensboro, North Carolina; Hartford, Connecticut; and Las Vegas, Nevada).
- *The SC2 National Resource Network (SC2 Network)* bringing together public and private resources to provide U.S. cities, towns and regions with one-stop access to national experts and federal resources. USD \$5 million will be awarded to an intermediary organisation to administer the Network.

Sources: “Strong Cities, Strong Communities allocates \$11 million to foster economic growth in American cities”, Press Release, HUD, No.12-103, 14 June 2012; “Obama Administration Announces Winners of Strong Cities, Strong Communities Challenge to Spur Economic Growth”, US EDA Press Release, 20 Sep 2012; Barnes, M. (2011), “Announcing Strong Cities, Strong Communities”, The White House Blog, 11 July 2011; Brown, A. (n.d.), “New Orleans selected for Strong Cities, Strong Communities”, The New Orleans Tribune online; German Marshall Fund (GMF) (2012), “Strong Cities, Strong Communities Fellowship”, GMF website.

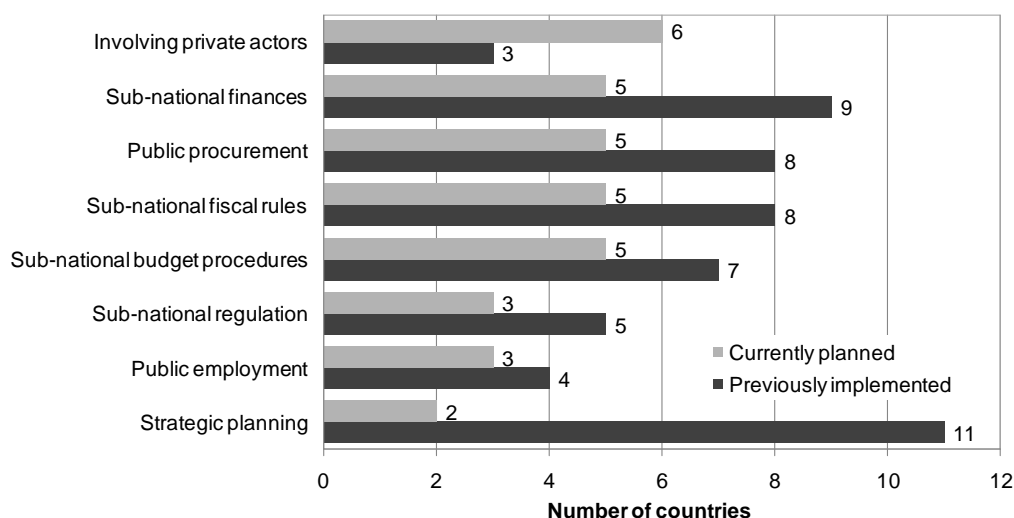
Other national examples include Switzerland, where capacity building is one of three key pillars of its “New Regional Policy”. The federal government dedicated CHF 11 million of its CHF 405.5 million 2008-2011 budget to capacity development. CHF 9.6 million was set aside for Regiosuisse, a network of three private companies launched in 2008 to provide assistance to cantons and regional agencies. It offers an internet portal, a telephone hotline, education and training opportunities, communities of practice, media information, and a research network to enhance linkages between research and practice. (OECD, 2011d) In Canada, the Federation of Canadian Municipalities, the National Research Council and Infrastructure Canada collaborated on the National Guide to Sustainable Municipal Infrastructure (InfraGuide) project. From 2001 to 2007, the project produced numerous case studies, best practice reports, and e-learning tools on the topic of sustainable municipal infrastructure. Over 50 reports remain available online (FCM, 2010).

Box 12: Capacity development efforts by national and regional governments

By the national level

Numerous efforts have been implemented or are currently planned by national governments to enhance sub-national capacities in the countries responding to the OECD survey. Past efforts have focused on policies linked to strategic planning (e.g. guidance to establish regional development strategies, contracts/partnerships across government levels), intergovernmental fiscal relations (sub-national finances and fiscal rules) and public procurement (e.g. simplification of procedures, technical assistance for contract management). Efforts anticipated for the future cover similar areas, but the greatest number of countries report plans to strengthen private sector involvement.

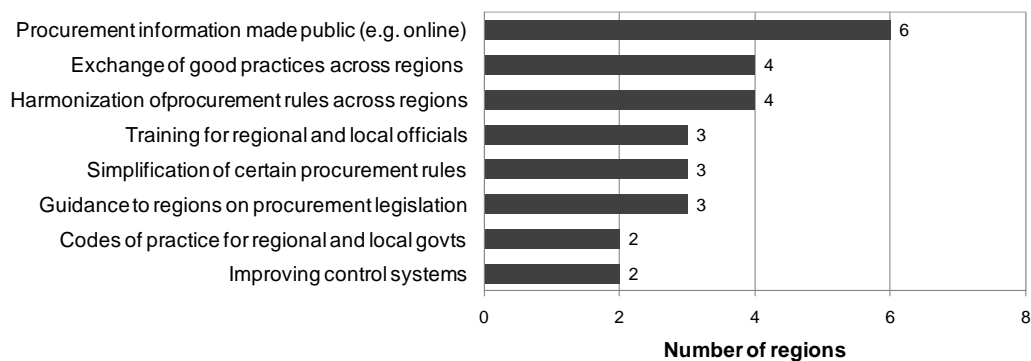
Figure 7: Areas targeted by central government efforts to strengthen SNG capacity



By regions

Regions also implement or take advantage of measures to improve capacity. In the area of public procurement, for example, the use of online procurement systems tops the list of useful practices in this regard (Figure 8). To improve public employees' capacity for planning/monitoring public investments, four regions reported providing staff with regular training (e.g. on contract management) and three reported use of performance evaluation for staff. Performance related pay and mobility within the regional administration were reported by two regions only. Nearly all regions indicated that they took advantage of some form of external support to bolster their capacity for public investment.

Figure 8: Practices used by surveyed regions to strengthen public procurement



Sources: OECD national and regional questionnaires on multi-level governance of public investment, 2012.

Formal guidance documents from higher levels of government can be useful to enhance technical capacity for activities such as strategic planning, ex-ante assessment, impact evaluation, etc. as well as to even out capacities across sub-national entities in key areas. The European Commission, for example, makes available a Guide to Cost-Benefit Analysis of Investment Projects for use in the context of EU Cohesion Policy. The usefulness of such documentation, however, depends on the ability of the individuals to implement the guidance consistently (Larsen and Myers, 2009). As such, provision of technical guidance should go hand-in-hand with assessment of and support for individuals' skills to implement it.

Capacity development within regions

Capacity development can be, and is, undertaken by regions and municipalities themselves. (Box 12 highlights some of the activities undertaken by surveyed regions to strengthen their own capacities for public investment.) Approaches to capacity development may involve structural/organisational changes within regions, identification and implementation of good practices, and workforce strengthening.

Structural/organisational changes for capacity building

Organisational changes can be a lever for regions to strengthen capacities. Changes require the region to first assess how effectively the relevant public service agencies are organized, and where the major co-ordination failures exist. In the state of Victoria (Australia), departmental capacity for developing and managing capital investments has improved in recent years. The Department of Treasury and Finance has done much to improve the state's overall institutional capacity for infrastructure investment – not only from the perspective of central quality assurance and control, but in terms of process guidance and research. The Government of Victoria also had a central department able to provide experienced technical staff to departments dealing with unusually big projects. There is capacity for departments to “contract in” consultancy support in highly technical areas and/or in periods of high demand. In the transport sector, policy advice was previously confined to its specific component areas- rail, roads ports etc. There is now a more strategic and joined up transport strategy.

Structural changes such as merging municipalities (or regions), engaging in inter-municipal (and inter-regional) co-operation, engaging in public-private partnerships, or the creation of agencies for certain sectors or regions can potentially strengthen medium-to long-term capacity through access to additional resources, expertise, and economies of scale. In such cases, the “solution” may require precisely some of the capacities that are lacking. In these cases, some aspects of capacity may be developed in the context of “learning by doing” over a period of time. Complementary support can come from a number of places. As noted earlier, national governments can support sub-national efforts to improve or increase horizontal co-ordination, for example. In addition, (co-) financing or even establishment of regional development agencies may be facilitated by higher levels of government. Creation of specific agencies/departments, such as PPP units, can also provide support for investment projects. This can be done at a higher or lower level of government to provide support to all jurisdictions and facilitate exchange of good practices across SNGs. Seventeen OECD countries have dedicated PPP units at the national level and four federal countries, Australia, Belgium, Canada and Germany, also have PPP units at the state/provincial level (OECD, 2010a).

The allowable timeframe for capacity development and the depth of capacity development needs are critical considerations with respect to “learning by doing”. Where time permits, “learning by doing” may even allow for asymmetric forms of decentralisation. In Sweden, for example, regions may apply for more competencies if they demonstrate to the national government that they have sufficient capacities to handle them. Four regions so far have a different status in Sweden, with additional competencies for regional development. The process has relied on experimentation, and has therefore been asymmetric throughout the

country. (OECD, 2010c) In other cases, the time needed for capacity development and learning by doing is unavailable. The current fiscal crisis in Italy, for example, has led central government to step in and assume responsibilities associated with public investment previously the responsibility of region due to a persistent capacity gap at the regional/local level (Mezzogiorno).

Identification and implementation of good practices

A culture of effective public investment management can be cultivated through productive use of monitoring and evaluation information, as well as through participation in communities of practice. As noted earlier, developing a feedback loop strengthens monitoring and evaluation as activities for learning and capacity development, as opposed to administrative formalities. Sub-national governments can also participate in professional networks which act as a platform for information exchange, training, and showcasing good practices. Sharing can occur among all regions within a country, among clusters of regions with similar characteristics or investment needs, or across international borders. In Switzerland, for example, inter-cantonal conferences act as a platform for regional co-ordination and within regional policy the Confederation has financed capacity building activities which include developing communities of practice (OECD, 2011d).

Bench learning and formal peer review could also be used as a capacity development tool for public investment. Exploring experiences of other countries and regions is a useful approach to identifying good practices and by-passing hurdles. With respect to PPPs, for example, Deloitte Research (2007) suggests that when sub-national governments are at the earliest in their capacity for PPPs (e.g. such as U.S. states and localities) they should learn from “trailblazer countries” such as the UK (for schools and hospitals) and Australia and Ireland (for roads), “to leapfrog to more advanced stages of maturity.” They go on to note, “for jurisdictions higher up the maturity curve looking to expand their use of PPPs into new sectors such as education and defence, among others, it is important for them to develop a deep understanding of the challenges and potential solutions particular to each infrastructure area.”³³ More formally, peer review, in which regions’ (or municipalities’) investment practices are examined by fellow regions (or municipalities), could be used to develop capacity within countries – as well as for international regions of comparable characteristics. Such peer review processes can be supported by higher levels of government, organised through sub-national co-ordinating bodies or associations, or facilitated by non-governmental actors such as universities, research entities and international organisations.

E-government tools can also strengthen regulatory capacity, as well as other aspects of public investment management and narrow gaps in capacity across regions. Such processes include, but are not limited to e-procurement, administrative burden reduction, automating data collection and reporting, and public consultation activities for citizens and firms. Most surveyed regions reported online procurement to be particularly useful for enhancing their capacity for effective procurement.

Strengthening workforce capacity

Sound HRM practices such as open, competitive hiring and merit-based promotion as well as targeted workforce training can enhance workforce quality. Among case study regions, workforce training and good practices in human resource management are frequent tools to bolster administrative capacity. For example, Wielkopolska (Poland) has made consistent efforts to improve administrative capacities of the regional administration. The staff

33 Deloitte Research (2007) identifies a maturity curve for government capacity for PPPs, characterised by three stages of development – with variation within each stage according to the amount of PPP activity and its overall sophistication.

employed by Skåne (Sweden) benefit from mobility within the regional administration and performance-related pay mechanisms. In Victoria (Australia), the government tapped a central department to allocate experienced technical staff to other departments dealing with unusually big projects. Where there is a significant level of procurement, maintaining a dedicated, well-trained procurement team with limited (or properly-timed) staff rotation can help sustain needed expertise and enable the government to react quickly when the financial environment changes (WEF, 2010). This suggestion is valuable for larger regions (e.g. Region Skåne has a specialised procurement staff of over 70 individuals), but smaller SNGs are likely to encounter human resource constraints.

Recourse to consultants and expert organisations can compensate where workforce quality is less than ideal, as well as transfer knowledge and build skills. As noted earlier, the skills required to design and manage an investment programme are comprehensive. It is not realistic to assume all of these skills will be found in-house, particularly for small sub-national governments. In fact, most of surveyed regions have turned to external supports in the design/management of public investment projects. For EU Cohesion Policy, governments use consultants to identify project opportunities, identify potential partners, help to prepare applications, fulfilling reporting duties, etc. (Rodrigo and Allio, 2012). During the 2000-2006 programming period, for example, the Italian regions of Lombardy and Sardinia brought external consultants “in house” to develop their monitoring information systems. In this way, the needed specialised skills were combined with internal knowledge about the local specificities that characterised the policy implementation context. (OECD, 2009a) In Germany, the regional development bank in Brandenburg (ILB) provides support to the regional and local governments. For innovation and R&D investments, for example, although the Länd’s innovation agency determines the allocation of innovation grants, the ILB manages the application process, especially the financial and technical assessments of the client’s application. It also offers support to municipalities in the areas of PPPs and waste/sewage treatment facilities. For waste/sewage treatment, poor investment choices led to financial problems for specialised associations of municipalities. For these cases, the ILB combines consultancy and financing functions in giving grants to help reduce the debts (Gamper, 2012a).

Enhancing the “enabling environment” through national policies and practices

Higher-level governments seeking to empower sub-national governments as drivers of growth must recognise the constraining or facilitating effects their policies and capacities have on sub-national public investment. As noted at the outset, responsibilities for public investment are shared among levels of government. The “enabling environment” for public investment and sub-national action is established (or strongly affected by) decisions taken at the (supra) national level. In some cases, central governments have primary responsibility for key aspects of the investment cycle, leading to an undeniable situation of shared capacity. Because of this multi-level governance context, examining sub-national capacities for public investment is insufficient without also acknowledging some of the ways in which (supra) national governments affect sub-national capacities. While it is beyond the scope of this paper to discuss all of the ways in which they do so, it is worth to briefly highlighting key aspects of four dimensions: policy frameworks for investment, integrity and transparency, regulatory quality, and macroeconomic health.

Policy frameworks

Setting, communicating and linking development priorities among levels of government are important for public investment. Toward this end, (supra) national governments should provide clear policy frameworks for public investment. If the overarching strategic framework for public investment is weak, development priorities may be hard to identify and cascade to lower levels of government. Potential synergies across sectors and policy goals may be lost. By contrast, clear policy frameworks and accompanying planning

guidance can anchor both (supra) national and sub-national policy and budgetary decisions, and provide a basis for preliminary project screening in terms of consistency with development goals.³⁴ Where countries undertake cross-sector initiatives with strong public investment components, such as green growth, clear policy frameworks can improve the likelihood that goals are met (OECD, 2012a). These frameworks take different forms, such as the Community Strategic Guidelines (for EU Cohesion Policy), National Strategic Reference Frameworks (NSRF) developed by EU countries for the 2007-2013 financial period of cohesion policy, which indicate the allocation of EU funds at the national level and provide guidance to SNGs.

Thirteen countries (out of 20) responding to the OECD questionnaire indicate that they have a national-level strategic guidance document in place setting out priorities for public investment across levels of government. The document is used primarily for general policy guidance on which more detailed sub-national guidance is drawn up, and to a lesser extent for providing concrete mandatory requirements for sub-national governments. The national-level strategic guidance document usually covers a multi-year period, ranging from four years in Spain to ten years in countries such as Poland and the Slovak Republic.

While the direction and emphasis of investment policies and programmes should be consistent across levels of government, this does not require an exact correspondence among priorities. Different countries, regions, and localities have unique characteristics, needs, and constituencies. In fact, regional differentiation is in itself a criterion of the quality of strategic planning at the sub-national level. A lack of differentiation has been reported as a challenge in EU countries by the European Commission, which considers regions' stated priorities to be too similar across regions with very different characteristics. It is not uncommon to observe sub-national governments aligning their priorities with those of the national government primarily to capture funds, without sufficient assessment of whether or not specific national targets fit sub-nationally. For example, the EU target that 3% of GDP be spent on R&D by 2020 does not mean that each region should adopt the identical target irrespective of their unique characteristics. Rigorous regional assessment of potential sources of growth can help establish investment priorities and appropriate targets. In other instances, investment objectives may differ between higher and lower levels of government. This "objective gap" (Charbit, 2011) emerges because alignment of objectives among tiers of government is not spontaneous (even among leaders of the same political party as their constituencies can differ). Where such a gap creates obstacles to effective investment strategies, intergovernmental platforms and adequate sub-national consultation procedures that allow actors to identify bottlenecks and strategies for moving forward can be useful. Earmarked grants and co-financing mechanisms can also contribute to aligning priorities among levels of government.

Integrity and transparency

The national and sub-national environments for public investment should be characterised by integrity, transparency, and accountability at all stages of the investment cycle. This is a broad, systemic capacity with relevance for each of the goals and critical capacities identified here. Good governance in this area prevents waste and corruption in the use of public funds, enhances accountability to citizens, and encourages trust in government. By contrast, shortcomings increase risk across the investment cycle, with corruption weakening the rate of return to both new and existing investment (Tanzi and Davoodi, 1997). While many examples of good practices exist in OECD countries, there remains a need to strengthen systems of integrity and transparency to buoy confidence in and efficiency of public investment systems.³⁵ Here again there is a role for peer review and bench learning across countries. At the

34. See, for example, Rajaram et al (2010: 3) and Dabla Norris et al (2011: 8) on the importance of such guidance "to anchor" national government decisions.

35. See for example a recent discussion of systems in Europe in Mulcahy (2012).

Box 13: Public investment in a decentralised context: a checklist for higher levels of government

The multi-level governance context of regional development policy means that policies and institutional arrangements at higher levels of government affect the “enabling environment” for sub-national public investment. Higher levels of government can make a positive contribution to the effectiveness of sub-national investment activities by reviewing and ensuring that their own capacities and institutional arrangements support, rather than hinder, sub-national governments. (Supra) national (or even regional) governments can examine a number of key areas:

Policy frameworks

- ✓ Is there a clear policy framework for public investment that sets out development priorities and can serve as overarching guidance for sub-national investment planning efforts?
- ✓ Does this guidance provide sufficient scope for sub-national governments to identify and pursue a path to growth tailored to their assets, potential, and impediments to growth?
- ✓ Does it support or encourage sub-national efforts to invest in both physical infrastructure and intangible infrastructure, such as skills and other innovation-related assets, to encourage long-term productivity growth?
- ✓ Are the development priorities reflected in current allocations and in medium-term budget plans?

Integrity and transparency

- ✓ Do national policies reflect the principles embodied in the OECD Recommendation on Integrity in Public Procurement?
- ✓ Is support for and collaboration with sub-national governments on issues of procurement available?

Regulatory quality

- ✓ Do national policies reflect the OECD Recommendation on Regulatory Policy and Governance, and the principles regarding regulatory quality across levels of government in particular?
- ✓ Is there evidence of regulatory obstacles to effective sub-national public investment, such as obsolete, excessive, or absent regulations? Regulatory institutions with inadequate capacities or overlapping responsibilities? Uneven application of regulatory instruments? Regulatory barriers that impede utilisation of cross-cutting funds?
- ✓ Have OECD recommendations to foster regulatory management capacity and performance at sub-national levels of government been considered and implemented?

Intergovernmental frameworks and support

- ✓ Do intergovernmental interactions reflect the view of sub-national governments as key partners, acknowledging the value of their knowledge, skills, and/or proximity to citizens and firms?
- ✓ Are guidance documents and technical support available to lower levels of government to support key public investment processes like strategic planning, ex-ante appraisal, public procurement, public-private partnerships, access to innovative financing, or ex-post evaluation?
- ✓ Are there established platforms for vertical exchange of ideas, concerns, and good practices across levels of government to reduce potential gaps or contradictions between policy objectives, fiscal arrangements and regulations across levels of government? In different sectors? For regional development generally?
- ✓ Are incentives available from higher levels of government to encourage horizontal co-ordination across local jurisdictions to increase economies of scale in investment projects?
- ✓ Are sub-national investments financed wholly or partially with funds from higher levels of government subject to monitoring and ex-post evaluation? Is M&E information used by higher levels of government for decision making in present and future investment cycles?

Sources: Authors' elaboration plus OECD (2011), *Making the Most of Public Investment in a Tight Fiscal Environment: Multi-level Governance Lessons from the Crisis*, OECD Publishing, doi: 10.1787/9789264114470-en; OECD (2012), “Recommendation of The Council on Regulatory Policy and Governance”, OECD; OECD (2008), “Recommendation of the Council on Enhancing Integrity in Public Procurement [C(2008)105], OECD.

EU level, for example, an initiative could be developed to foster learning and exchange of good practices across regions and countries for public procurement.

Sub-national governments have an important role to play to ensure integrity and accountability, but they do not act alone. Good practices with respect to accountability and control are many. Policies should address both internal control (systems for hierarchical

supervision, reporting and accountability) and external control (independent scrutiny by the Supreme Audit Authority, and oversight by the judiciary, legislature and the public), as well as conflict of interest, whistleblower protections, proper consultation procedures, etc. Many of these policies involve higher levels of government and what arrangements will work best for a particular country or sub-national government will depend on a variety of factors, including a country's system of government.³⁶ It is beyond the scope of this paper to discuss the range of options available to governments. What is crucial is that national and sub-national arrangements minimize/eliminate the risk of corruption, promote accountability and transparency in the use of public funds, and result in accurate, credible financial and performance reports regarding sub-national investment projects. Robust processes should exist to ensure that mistakes and wrongdoings are put right. Sound national practices are particularly critical where sub-national actors rely on higher levels of government to undertake or lead critical investment processes, such as ex-ante appraisal or procurement.

Policies adopted in pursuit of integrity and accountability for sub-national public investment should take account of sub-national capacities to undertake them, and promote effective oversight rather than micro-management. In establishing policies to reinforce integrity and accountability, higher levels of government should evaluate the workload, incentives, and intergovernmental dynamic that may result for sub-national governments. There is a risk that policies can overwhelm the workload or capacities of sub-national governments. For example, the consultation process for the EU's Fifth Cohesion Report revealed a demand by member states, regions, and non-governmental stakeholders for a clarified and simplified audit requirement for the use of Structural and Cohesion Funds, with a suggestion that audit requirements be "proportional to the risks and resources to be managed" and a call for greater co-ordination between the Commission and member states (EC, 2011a). Micro-management can also encourage gaming or superficial implementation (rather than honest reporting or proper implementation) and weaken intergovernmental partnership arrangements if excessive control leads to unnecessary disempowerment and lack of trust.

Regulatory quality

As noted earlier, regulatory quality and coherence across levels of government play important roles in public investment, particularly where competences are shared and each level of government has an important role to play to achieve policy goals. Coherence facilitates proper, timely, and efficient use of public funds for investment (Rodrigo and Allio, 2012), and makes the environment for private investment more attractive.³⁷ The OECD (2012b) has specifically recommended that higher levels of government "foster the development of regulatory management capacity and performance at sub-national levels of government", and suggests eight specific ways to do so (Box 14). Ten respondents to the national questionnaire suggest that regulatory and administrative obstacles are a challenge for co-ordinating public investment across levels of government.

Reflecting on the state and maturity of the regulatory environment when establishing investment priorities and corresponding programmes can help to ensure that the right regulations exist across sectors to facilitate integrated place-based investments. A review can reveal potential obstacles to the efficient use of public funds, such as obsolete or excessive regulation, the absence of enabling regulations, unnecessarily complex regulation which imposes costs and deters investment and SME creation, regulatory institutions with inadequate capacities or overlapping responsibilities, uneven application of regulatory instruments, or

36. In federal countries, for example, sub-national audit authorities have often been established by sub-national law. Some unitary countries have established regional audit offices (e.g. France) which can audit the accounts of sub-national governments (OECD, 2004a).

37. For practices to increase regulatory coherence see Allio et al (2009) and García Villarreal (2010).

Box 14: OECD recommendations to foster regulatory management capacity and performance at sub-national levels of government

- Governments should support the implementation of regulatory policy and programmes at the sub-national level to reduce regulatory costs and barriers at the local or regional level which limit competition and impede investment, business growth and job creation.
- Promote the implementation of programmes to assess and reduce the cost of the compliance with regulation at the sub-national level;
- Promote procedures at the sub-national level to assess areas for which regulatory reform and simplification is most urgent to avoid legal vacuum, inconsistencies, duplication and overlap;
- Promote efficient administration, regulatory charges should be set according to cost recovery principles, not to yield additional revenue;
- Support capacity-building for regulatory management at sub-national level through the promotion of e-government and administrative simplification when appropriate, and relevant human resources management policies;
- Use appropriate incentives to foster the use by sub-national governments of Regulatory Impact Assessments to consider the impacts of new and amending regulations, including identifying and avoiding barriers to the seamless operation of new and emerging national markets;
- Develop incentives to foster horizontal co-ordination across jurisdictions to eliminate barriers to the seamless operation of internal markets and limit the risk of race-to-the bottom practices, develop adequate mechanisms for resolving disputes across local jurisdictions;
- Prevent conflict of interest through clear separation of the roles of sub-national governments as regulators and service providers.

Source: Excerpted from OECD (2012), "Recommendation of The Council on Regulatory Policy and Governance", OECD, Paris.

underdeveloped use of regulatory tools at various levels of government. Regulatory barriers in specific sectors could also deter proper utilisation of cross-cutting funds such as EU Structural and Cohesion Funds, for example. (Rodrigo and Allio, 2012) Examination may also reveal sub-national regulatory constraints that hamper national policies intended to bolster SMEs or encourage start-ups in area such as access to credit or access to resources for R&D and innovation (e.g. for university spin-offs and SMEs incubators).

Efforts to reduce the administrative burden for sub-national governments can be helpful – particularly for small ones where the proportion of resources dedicated to administrative functions is greater than for their larger counterparts. In the Netherlands, the Association of Municipalities has proposed that each ministry appoint a co-ordinating lawyer for new regulation that will affect the local level. In 2010, France established a moratorium on costly norms imposed on sub-national governments. (OECD, 2011c) Slovenia recently reduced its stock of regulation – a priority in a country with frequent change in the regulation for spatial planning, which made it almost impossible for municipalities to stay up-to-date.

Additional good practices used for the co-ordination of regulatory policy also include mutual recognition policies among governments, regulatory harmonisation agreements, and strict regulatory uniformity agreements (OECD, 2009b).

Macroeconomic health

While examining the impact of macroeconomic policies on sub-national finances is a topic sufficiently large for a separate paper, **it is important to recognise that the broader economic environment in which sub-national governments operate acts as a constraint or a**

facilitator of sub-national investment. National governments often seek to avert potentially negative macroeconomic effects of sub-national policies, i.e. through the implementation of fiscal rules. But negative impacts flow downward as well. The 2008 financial crisis, for example, has had long-lasting effects on sub-national governments.

Access to credit, an important dimension of sub-national capacity for public investment, can be negatively affected by national policies. National economic weakness, sovereign downgrades, and poorly constituted intergovernmental fiscal arrangements have effects that cascade downward, negatively affecting sub-national governments (Liu and Tan, 2009). Sub-national credit ratings, which fundamentally affect access to credit, are highly dependent on sovereign ratings – particularly for countries outside the U.S. (Gaillard, 2012). While the U.S. is a something of a special case,³⁸ even there, exposure to sovereign risk (e.g. through high levels of intergovernmental transfers) can have negative effects for sub-national governments.

Conclusions

Capacity development for sub-national public investment is a multi-faceted process, involving actors at all levels of government. The multi-level governance context of public investment means that actors at all levels of government have responsibilities for public investment, and corresponding obligations in terms of capacities and capacity development. A whole of government, multi-level approach is needed to ensure well-functioning investment systems.

Capacity development can occur in a variety of ways. It can be conducted in the context of vertical relations, embedded in contractual arrangements, and approached as a partnership between levels of government. Sub-national governments can also undertake capacity development on their own – engaging in self-assessment and seeking to strengthen areas of weakness through changes to institutions, adopting good practices, increasing resources, and improving workforce capacity. Finally, higher levels of government can examine their own role in establishing the “enabling environment” for sub-national public investment. Here (supra) national governments may find ample opportunity to modify policies and practices in ways that can facilitate improvements across all levels of government. Clearly, capacity development is not restricted to training and workforce improvement activities, but also extends to the implementation of good policies and practices at all levels of government.

38. U.S. states and municipalities tend to be less dependent on the sovereign rating less than SNGs in other countries. Their own economic and financial performances matter greatly. However, in times of recession or depression, exposure to sovereign risk through high levels of intergovernmental transfers means that even U.S. SNG ratings are affected by their respective sovereign rating. However, a U.S. SNG can preserve its (high) rating and even get a rating higher than that of its respective sovereign if its economic situation is strong. This has occurred in other federal (or regionalised) countries such as Canada and Spain – although this tends to be the exception rather than the rule. (Gaillard, N., pers. comm. to L. Mizell, 15 July 2012; Moody’s, 2011a; Moody’s 2011b, Cauchon, 2011)

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