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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 05/45-2

10:11 a.m., May 20, 2005

2. Public Investment and Fiscal Policy—Lessons From the Pilot Country Studies; Public Investment and Fiscal Policy—Summaries of the Pilot Countries; Government Guarantees and Fiscal Risk

Documents: SM/05/118; SM/05/119; and SM/05/120

Staff: Ter-Minassian, Hemming, and Schwartz, FAD

Length: 2 hours

Executive Board Attendance

A. Krueger, Acting Chair

Executive Directors	Alternate Executive Directors
	A. Alazzaz (SA)
K. Bischofberger (GR)	
P. Duquesne (FF)	O. Cuny (FF)
N. Jacklin (UA)	
	T. Miyoshi (JA), Temporary
	L. Veziroglu (BE), Temporary
	Y. Yakusha (NE)
	M. Kruger (CO), Temporary
	A. Mohammed (MD), Temporary
B. Misra (IN)	
	S. Vtyurina (RU), Temporary
	J. Steytler (AE), Temporary
	R. Murray (AU)
	D. Sembene (AF), Temporary
	C. Gola (IT), Temporary
	R. Steiner (BR)
T. Scholar (UK)	
	R. Calderón-Colín (CE), Temporary
	O. Kanaan (MI)
J. Solheim (NO)	
	J. Silva-Ruete (AG)
	D. Vogel (AG), Temporary
X. Wang (CC)	
	A. Raczko (SZ)
	W. Wesaratchakit (ST), Temporary

S.J. Anjaria, Secretary
A. Tarantino, Assistant

Also Present
IBRD: A. Rajaram. African Department: S. Gupta. Asia and Pacific Department: P. Berezin, T. Rumbaugh. European Department: A. Leipold. External Relations Department: J. Hayden. Fiscal Affairs Department: I. Adenauer, E. Ahmad, T. Catsambas, A. Cuevas, J. Daniel, J. Davis, R. Hemming, M. Kumar, R. Ossowski, G. Schwartz, A. Segura, T. Ter-Minassian, M. Verhoeven. International Capital Markets Department: P. Ross. Policy Development and Review Department: M. Allen, R. Kincaid. Secretary's Department: A. Blazejewski, P. Ramlogan. Statistics Department: K. Dublin, L. Laliberte. Western Hemisphere Department: T. Alleyne, A. Cheasty, R. Rennhack, C. Sancak. Senior Advisors to Executive Directors: C. Amador (AU), L. Croitoru (NE), P. Gitton (FF), N. Guetat (AF), K. Kanagasabapathy (IN), P. Moreno (CE), K. Nauphal (MI), L. Palei (RU), Y. Patel (AE), S. Rouai (MD),

G. Shbikat (MI). Advisors to Executive Directors: R. Gregory (UK), S. Keshava (SA), D. Nuraliev (SZ), A. Prasad (IN), S. Segal (UA), G. Sidlauskas (NO), V. Srinivas (IN), E. Valle (CE), S. Wolff-Hamacher (GR).

2. PUBLIC INVESTMENT AND FISCAL POLICY—LESSONS FROM THE PILOT COUNTRY STUDIES; PUBLIC INVESTMENT AND FISCAL POLICY—SUMMARIES OF THE PILOT COUNTRIES; GOVERNMENT GUARANTEES AND FISCAL RISK

Mr. Yakusha and Mr. Stucka submitted the following statement:

Introduction

The empirical evidence on the linkages between public investment and economic growth is mixed. This may be explained by the fact that public investment expenditure is only partly aimed at improving directly the allocation of resources and raising productivity. A significant share of public investment could be devoted to the maintenance of other basic government functions, as well as social and environmental objectives that do not or indirectly contribute to output growth with a certain lag. Therefore, the absence of unambiguous evidence in the pilot countries is not surprising.

Focus on the Overall Balance and Public Debt

Tax issues and policy uncertainty topped the list of private sector concerns in a number of pilot countries. We see merit in further empirical analysis on these issues, rather than on the relationship between public investment and growth. This task we see more to be in the realm of the World Bank.

As stated in our previous gray on this issue, fiscal policy should primarily remain focused on the overall budget balance and debt. Public investment and PPP projects should not be used as accounting exercises to circumvent the fiscal budget. In countries with high debt levels, preserving macroeconomic stability and ensuring debt sustainability is necessary through fiscal discipline creating room within the existing envelope for additional public investment. Thus, we agree that the emphasis should be on expenditure prioritization, given the difficulties involved in achieving a sustainable increase in revenues in many countries. The World Bank and other MDB's with expertise in project appraisals and project implementation should provide the authorities with appropriate evaluation tools while exercising their leading role in advising countries on prioritizing, implementing, and monitoring public investment, inter alia, through public expenditure reviews and training in project management.

Inclusion of SOE based on fiscal risks rather than commercial orientation

Furthermore, as the pilot studies have shown, the inclusion of public enterprises in fiscal targets should not be based on their commercial orientation. Rather, it appears more appropriate to include public enterprises based on the assessment of fiscal risks they entail for the budget. Therefore, we support the staff's intension to start placing more weight on extending the fiscal coverage to take account of relevant public enterprises based on their fiscal risks. However, the pace of implementation in this area should be measured and subject to prioritization.

Contingent liabilities are a particular source of concern in the handling of public-private partnerships (PPPs). While traditional public investment usually entails a fixed up-front expenditure, PPPs take the form of a stream of future obligations enabling the authorities to place capital spending outside the overall budget balance. This may create a bias toward PPPs that is not warranted to the same extent by increased micro-economic efficiency of PPPs compared to traditional public investment. This underlines the need for transparent accounting practices and the inclusion of contingent liabilities in debt sustainability analyses.

Finally, we see merit in a broad-based outreach effort on government guarantees and fiscal risks and, therefore, encourage the staff to publish the results of their pilot studies in one of the Fund paper series.

Mr. Steiner submitted the following statement:

Main Points

▪ The main cause behind many recent declines in public investment has been the need to trim expenditure in the context of a sharp decline in foreign financing, in countries with budgetary rigidities and where the tax burden is already high.

▪ Additional infrastructure spending should not be created by changes in accounting.

▪ The experiences of Brazil and Colombia with the pilot program were extremely positive.

▪ Key in determining if a PE should be part of the public sector or not is whether it poses significant fiscal risks to the government. Quasi-fiscal activities, if accounted and presented in a transparent manner, should not deter from excluding PE's from public sector accounts.

▪ The broad coverage of the public sector in Latin America should be the norm throughout the membership. As a transition mechanism to ensure uniformity of treatment, in countries which already include all PEs in fiscal accounts, the Fund should accept adjustors to allow for investment conducted by certain PEs to be deducted from fiscal targets.

▪ There is a strong need for developing an internationally accepted accounting and reporting standard for PPPs, and the Fund should press for full disclosure of financial risks. We are concerned with the possibility of countries tailoring PPPs to meet the requirements for their classification as private investment, a risk that could loom large in EU accession countries.

▪ Staff should proceed with caution on the issue of whether or not to include PPPs and other government obligations when assessing debt sustainability. Since the list of potential candidates has no limit, we would urge for not including any implicit liability in the DSA.

We thank staff for an interesting set of papers, and support most of the proposed recommendations.

We concur with staff that the relationship between public infrastructure and growth is difficult to gauge and that there is no obvious way to assess investment and rehabilitation needs. We do not agree, however, on the difficulty of understanding the causes and consequences of recent declines in public investment in some developing countries, including many that participated in the pilot. The main cause behind many of the recent declines in investment has been the need to curtail public expenditure in the context of a sharp decline in foreign financing, in countries with budgetary rigidities and where the tax burden is already high. The reason why in Brazil and Colombia public investment has not evolved as the authorities would have wished was neither because there is a conviction that the public sector should be scaled-down, nor because there is skepticism about its effects on growth. Trimming productive investment was a key component of the effort to improve the fiscal accounts. The benefits of restoring macroeconomic stability have come at the cost of not dealing with bottlenecks in infrastructure, including ports and roads in Brazil and roads in Colombia.

Staff provides evidence that private investment is sensitive to high taxes, policy uncertainty, macroeconomic instability, corruption, and cost of financing, and that deficiencies in infrastructure are not a driving force of private investment decisions. While we are not surprised by these findings, we believe staff somewhat misses the point that motivated the call from many Latin American leaders to the Fund and the World Bank to revisit the issue of public investment and fiscal policy. When leaders in our region called on the IFIs to explore innovative ways to enhance the government's ability to undertake investments in infrastructure, the view was not that this would increase private investment or that it would serve as a substitute for addressing issues of high taxes, policy uncertainty, or macroeconomic stability. In our view, the motivation was to highlight that well-identified bottlenecks in infrastructure—which were acting as an impediment for a more effective and productive functioning of private sector resources—needed to be addressed.

Also on the issue of private investment, staff makes the claim that governance issues are very important. While we do not disagree with this view, the point that staff fails to discuss is that, in many countries in the pilot program, private investment used to be much higher than what it now is, although governance indicators were worse, or not better, than what they now are. The issue of relevance for many countries in our region is not whether good governance is important or not—a fact that is not disputed—but rather why is it that private investment is so cyclical and why trimming public investment has to be such an important component of fiscal consolidation? The papers at hand make some contributions to the second point, but do not refer to the first—other than to, once again, remind us that governance is important. We would also add that, similarly to what happens with the relationship between infrastructure investment and growth, the relationship between governance and investment is also difficult to gauge in precise terms.

We concur with staff that room for additional infrastructure spending cannot be created by changes in accounting. Our authorities have always been of the view that the pilot program has to be conducted keeping in mind the need to safeguard macroeconomic stability and fiscal sustainability. That said, it is almost inevitable to conclude that increases in infrastructure investment, in addition to using some room in fiscal targets where this might exist, will require expenditure re-prioritization and maybe additional revenue mobilization.

The experiences of Brazil and Colombia with the pilot program were extremely positive. In Brazil, a series of public investment projects identified through a strengthened mechanism of appraisal, selection, monitoring and implementation will be executed, requiring a modest 0.15 percent of GDP, which, if necessary, will entail a reduction in the primary surplus target of 4.25 percent. The careful selection of these projects will ensure that debt sustainability is secured, even if the small decline in the primary surplus were to materialize. In the case of Colombia, the authorities fully agreed with staff that it would be very risky to consider a significant relaxation of fiscal targets to accommodate enhanced public investment spending. As a result, the 2005 fiscal deficit target under the new Fund program is expected to accommodate only around 0.2 percent of GDP of additional public investment in well-identified projects with a high expected rate of return.

On the issue of public enterprises, we agree with staff that the key issue in determining whether a specific company should or should not be part of the public sector is whether it poses significant fiscal risks to the government, rather than whether it has managerial independence or not. We believe, however, that the revised proposed criteria are unnecessarily restrictive. It seems to us that staff is establishing a high hurdle, which hardly any PE will ever satisfy. We believe that quasi-fiscal activities, if dully accounted for and if presented in a transparent manner, should not deter from excluding certain PE's from the public sector accounts. Staff's comments would be appreciated.

Coverage should be similar throughout the membership, and the broad coverage of the public sector in Latin America should become the norm for all countries and regions. In particular, broadening the coverage of the public sector should be achieved promptly in those countries in which the information is readily available. Staff is correct when arguing that inadequate coverage of PEs can pose significant fiscal risks and weaken the effectiveness of surveillance. We support the discussion between staff and the authorities of the time horizon for inclusion of PE's during future Article IV consultations, as well as a testing of the proposed criteria in a representative sample of countries. Meanwhile, in countries which already include all public enterprises in fiscal accounts, as a transition mechanism aimed at ensuring uniformity of treatment amongst members, the Fund should be prepared, in its programs and surveillance work, to accept adjustors to allow for investment conducted by certain public enterprises to be deducted from fiscal targets.

The pilot programs have provided useful information on PPPs. We concur with staff that they should be carried out for good reasons (i.e., increasing efficiency) and not by the desire to move expenditure off budget. We are discouraged by the fact that no developed country volunteered to participate in the pilot. In certain developed countries PPPs became particularly popular at the same time that these countries had to comply with the Maastricht criteria on fiscal deficit and public debt. There is a strong need for developing an internationally accepted accounting and reporting standard for PPPs, and the Fund should press hard for full disclosure of financial risks.

It seems evident from the papers that some Latin America countries—particularly Chile and Colombia—have a much better practice for assessing and distributing risk between the government and the private sector than countries that subscribe to EUROSTAT. We are concerned by the risks highlighted in paragraph 50 in reference to the possibility of countries tailoring PPPs to meet the requirements for their classification as private investment, a risk that could loom large in EU accession countries. We agree with staff that this would defeat the purpose of PPPs, and disguise their long-term fiscal implications.

On the issue of whether or not to include PPPs and other government obligations when assessing debt sustainability, we believe staff should proceed with caution. While DSA could benefit from the inclusion of legal obligations which limit the government's ability to undertake fiscal adjustment, we strongly disagree with the inclusion of implicit contingent liabilities. This exercise is akin to opening a Pandora's Box. Should, for example, deposits in the financial system be included, given the strong presumption that government's generally bail-out, at least partially, financial institutions under distress in order to prevent a full-blown financial crisis? Should we include future pension liabilities? Should one also include implicit assets, such as those stemming from a rich bio-diversity? Since the list of potential candidates has no limit, we would urge for not including any implicit liability in the DSA.

Mr. Misra and Mr. Gauba submitted the following statement:

We welcome the attention that the issue of public investment in infrastructure again seems to be receiving in the Fund and the Bank as well as other multilateral development banks. The pilot studies have broadly confirmed that public investment has declined in recent years in several of the pilot countries and that it was not offset by higher private investment. It can be reasonably presumed that this is part of a general trend in the developing and low-income countries.

One of the conclusions of the studies is that "neither the causes nor the consequences of this decline are fully understood." One can hardly argue with a statement like this and it could apply to any subject, as "full" understanding is elusive and quest for such perfect understanding can and should go on. But in the meantime, the way forward has to be defined. While a number of contributing factors are mentioned, what is not analyzed or even indicated is the possible correlation of this trend with the incidence of Fund-supported programs. It may not be entirely coincidental that many of these countries have been under such programs in the period studied. It is no secret that in program countries, the magnitude and composition of "fiscal consolidation" efforts and "a growing preference for private sector"—two of the four factors cited by staff—are not entirely country-driven or country owned. We would like this aspect to be studied in detail.

Our view, reiterated from time to time has been that in the last several years the overwhelming importance given to social sector expenditure in Fund-supported programs, particularly under the PRSP-PRGF framework, and in the lending policies of MDBs, could have contributed to a decline in the overall investment on public infrastructure in the developing and low income countries. We believe that while such an approach may have resulted in improved human development indicators in the short term, it is detrimental to the interests of sustained long term economic growth, which in turn is a necessary condition for the governments to have the capacity to allocate requisite levels of resources to health and education on a continued basis.

Decline in public investment per se may not be a cause for concern. The real issue is whether infrastructure needs-creating new assets as well as maintaining and upgrading existing ones-are being met. If this can happen through private sector, well and good. But as the pilot studies have brought out, this generally did not happen. In our view, the reasons are not far to seek. The ground reality in most of the developing and emerging economies is that private investment in infrastructure creation materializes gradually and the enabling policy framework is only one of the constraints. In fact, in some of the sectors, there may be no alternative to public investment, for instance where gestation periods are long, and profits low and uncertain. An example is roads, especially roads in the rural sector, a point which the pilot study on India also notes. Again, this phenomenon is not something unique to this group of countries. We have the experience of advanced countries where, when they were at a less advanced stage, it is the governments that undertook massive investments to build a network of highways, and even today, with far more developed capital markets and buoyant private sectors, governments continue to play a major if not the lead role in developing, maintaining and expanding roads and mass transportation systems. In maintenance of public infrastructure too, the example of private maintenance of schools and hospitals cited in the staff report may be difficult to replicate in the vast rural areas in large countries.

We believe that in the Fund-programs and in the overall approach of BWIs, there has been a tendency to prematurely and excessively emphasize the private sector's role in infrastructure creation and consequently overestimate the private sector investments. It would be useful to examine the experience as to how ambitious the program assumptions have been in this regard, with a view to assimilating the lessons into Fund's future advice and program design. We believe that the expectations that by improving governance, and creating a liberalized policy environment, investment in infrastructure will follow may have fallen significantly short of actual outcomes. Macro, regulatory, governance and financing issues all have a combined role to play and the relative weights of these factors depend on prevailing circumstances.

In several areas of infrastructure development, there could be a thin line separating social and economic infrastructure. If governments were to invest only in social infrastructure, where cost benefit ratios are difficult to estimate and not attractive to the private sector, it could contribute to fiscal stress.

Regarding the consequences of declining public investment in infrastructure, the pilot studies were "unable to determine to what extent growth and growth prospects may have been adversely affected by declining public investment, as compared to other factors." We are constrained to observe that despite the findings of the pilot studies, there is a continued tendency to downplay the relative importance of infrastructure. We believe that while there can be differences regarding the exact magnitude of impact, decline in investment on infrastructure in countries where considerable infrastructure gaps still exist, could not but have impacted significantly on private flows, including FDI, and growth. Several emerging economies have in recent years demonstrated the direct, catalytic, and enabling role of public investment in infrastructure. Such investments have played a major role in attracting large private investments, including FDI, and facilitated the launching of these economies into high growth trajectories. We are afraid that there is reluctance to acknowledge that other factors have been over-emphasized in relation to infrastructure. This could hinder drawing of appropriate lessons from these studies and integrating them into Fund's future work.

Thus, while in the absence of concrete evidence, staff are unable to say with confidence about the impact on growth and growth prospects, some surveys have been cited to make the case that “high taxes,” “policy uncertainty,” and “corruption” are amongst the top-ranked concerns of private sector, whereas “public infrastructure issues” are at the bottom of investor concerns. We would like to point out that there are countries that have failed to attract investment despite strong institutions and regulatory frameworks and structural reforms undertaken in line with Fund-programs whereas there are countries that have attracted very considerable private investment, including FDI, primarily on the strength of high quality infrastructure and despite lacking a transparent policy framework or a strong institutional set-up. We agree that each of these factors is important but it is disconcerting to see the continued tendency to downplay the relative importance of infrastructure.

Similarly, on the issue of estimating the public infrastructure investment requirements, the reference to the notion of “catching up with more advanced countries” is not really relevant, except from an aspirational viewpoint. In fact, given the rather low levels of existing infrastructure but the high capital requirements, the authorities in the developing countries cannot but be modest in their endeavors. On the other hand, we have seen in the context of several Article IV staff reports, even for countries with significant revenue surpluses and acknowledged needs to diversify economies, staff commenting rather unfavorably on the authorities’ efforts to build the enabling infrastructure in their pursuit of stimulating private sector led investment economic diversification.

Regarding decline of public investment in infrastructure in non-program countries, as the report observes, there are trade offs between public infrastructure spending and other spending as well as between taxes and expenditure. How these are addressed would depend on country specific circumstances, including the very important political economy considerations, and the inter-governmental fiscal relations in a federal set-up. Improved project appraisal and monitoring can also help ease investment constraints and should be targeted as a priority issue. Allocation of adequate budgetary resources to maintenance and rehabilitation of existing infrastructure is another vital issue that often receives less than the desired level of attention.

Ultimately, the authorities have to create space for additional infrastructure investment without jeopardizing macroeconomic stability and debt sustainability by an appropriate mix of expenditure restraint and reprioritization, and revenue mobilization. What level of deficit and what level of debt is consistent with these objectives will have to be determined by the country authorities depending on their assessments of the efficiency of expenditure, the quality of investments, projections of impact on growth, and their own medium term fiscal framework and rules.

The "overall fiscal balance targets," referred to in the staff report are therefore to be determined by the country for itself and there has to be an inherent degree of flexibility about them. However, the impact of infrastructure investment on future growth revenues and potential government liabilities is hard to predict and therefore accommodating additional investments through redefinition of fiscal indicators is not a desirable option. While the overall fiscal balance should be the primary indicator, our view is that for assessing macroeconomic stability and debt sustainability, a multiple indicator approach, with complementary focus on the current fiscal balance, taking into account the composition of spending may be more appropriate.

On the coverage of public enterprises in fiscal targets, the proposed gradual approach to shifting the focus from assessing the commercial orientation of public enterprises to assessing their fiscal risk potential is worth trying. However, instead of following the proposed revised criteria as a rule of thumb, each country may develop its own structure and periodicity of data and the specific emphasis on the focus of data. Regarding specific criteria, the existence of explicit or implicit budget transfers or guarantees should be given primary consideration. It should be seen that the residual risks to the government from their operations are taken into account. The debt of a commercially run public enterprise should not represent an actual or contingent government liability. However, the other suggested criteria like managerial autonomy, pricing policy norms etc. may not be appropriate due to subjectivity in assessment, and as comparison of domestic prices with international market prices cannot provide correct guidance. This is particularly true of public utilities.

Public private partnerships can be a useful instrument for increasing infrastructure investment, as private sector has failed to fill the promised gap of public investment in infrastructure. Some of the initial optimism in this regard has proved illusory as investors put their money only in projects that are providing a reasonable return and within the short term, like toll roads, ports, airport management etc. but many utilities with a wider consumer base could not be run by the private sector on market terms. PPPs have the potential to ease fiscal constraints of government in mobilizing finance to meet the investment needs for infrastructure projects and make provision of services more efficiently. Possibilities exist particularly in areas where privatization of public utilities is not feasible for a variety of reasons including the public good nature of services. They can also contribute to enhanced efficiency.

However, the tendency of using this route for setting up infrastructure projects to circumvent fiscal rules should be guarded against. We therefore agree with the suggested approach that in the absence of an internationally agreed fiscal accounting and reporting standard for PPPs, the known future costs deriving from government's contractual obligations as well as potential future costs associated with guarantees should be disclosed.

While a well developed institutional and legal framework, proper accounting practices and transparent disclosure requirements are important for fostering private investment in infrastructure, several developing countries may have inadequate capacity in these areas. Could the Fund-Bank take the initiative to help develop such frameworks and standards in these countries?

Finally, we believe that in PPPs, risks should be shared between the partners and therefore government guarantees as a rule is not the appropriate public policy, given the fiscal risk implications, difficulties in ensuring full disclosure and transparency on part of private players etc.

Ms. Phang and Mr. Wesaratchakit submitted the following statement:

We thank staff for a set of well-written papers and welcome the opportunity to discuss the lessons learnt from the pilot country studies. We take note of the finding that public investment has declined in recent years but neither the causes nor the consequences are fully understood. There is as yet no unambiguous evidence on the relationship between public investment and growth while most of the available evidence is anecdotal. Nevertheless, on a conceptual basis, it is hard to believe that public investment could have no impact on growth as it would be reasonable and logical to expect that public infrastructure investments—irrigation and public road projects, schools etc.—improve the living standards and productivity of the general population, thereby increasing economic efficiency and enabling the country to better utilize its resources for productive purposes. As such, we are of the view that this is a critical and important area which merits further research. It is not surprising that that investment climate surveys found that issues related to public infrastructure were not top-ranked. In fact we would expect that the most important concern for investors would be political stability, and while corruption would be an important concern, it would not be as important as the existence of important institutions such as legal protection for investors and a reasonable availability of infrastructure. How important the latter is depends on the threshold of availability of infrastructure i.e., infrastructure would be a more important factor if the existing level of infrastructure is poor and therefore the country needs to catch up on it. If, however, reasonably good infrastructure already exists as for example in middle income countries, then public expenditure on infrastructure is less important for generating growth and we would expect the relationship between public investment in infrastructure and growth to be insignificant. We wonder if staff did take this factor into account in their study.

If and when more definitive conclusions can be drawn from the additional research and analysis, it can be applied to make the debt sustainability analysis (DSA) more dynamic. At present, the analysis does not assume any significant upward shift in the baseline projection for GDP growth as a result of infrastructure spending. Yet, many developing countries have successfully used expenditure on public investment as a countercyclical tool to spur growth. The projects for public investment in those instances are carefully selected in terms of the strength of interlinkages with other sectors of the economy to optimize on the growth impact. Since the DSA result is expected to be sensitive to the growth assumption, the present DSA may not accurately reflect the available fiscal space that can accommodate additional infrastructure spending. This is of crucial significance given that it is essential for developing countries to strengthen institutional frameworks (most often through public investment) to attract foreign direct investment for economic development. If private investment is not forthcoming to strengthen the institutional framework, then public investment is necessary. There are no two ways about this.

We take note of the two approaches—catching up and bottlenecks—used by staff to estimate the magnitude of infrastructure investment needs. However, we are of the view that the amount of investment required that is derived from either approach should not be set as a rigid limit on infrastructure investment. Decisions on whether to undertake particular projects should be guided, if not based on, the use of cost-benefit analysis on a case-by-case basis. For low-income countries, we share staff's view that the resource and capacity constraints should be taken on board when determining project implementation. Creditor countries can assist these countries by extending greater financial assistance through more grants or soft loans for targeted infrastructure needs. In addition, the MDBs should assist them in improving their capacity by transferring the expertise and knowledge in project evaluation and implementation through more interactive and cooperative technical assistance. For middle-income countries, there is more scope for private sector involvement. Hence, MDBs such as the World Bank can help in the setting up of strong institutional frameworks (e.g., strong regulatory framework, property rights, enforceability of contracts, appropriate PPP framework) to foster private sector investment in infrastructure while the IMF should focus on the overall fiscal balance, and its implications for macro stability and debt sustainability, when assessing the scope for increasing public investment. We also agree with staff's recommendation that adequate resources should be allocated to the timely completion of ongoing projects as well as the maintenance and rehabilitation of existing infrastructure.

We support staff's proposal to take a flexible approach on the consolidation of the operations of public enterprises on a country-by-country basis. However, we encourage staff to proceed cautiously on discussions with the authorities on the government's plans and time horizon for the consolidation. Due to country-specific political and capacity constraints, it may be difficult for countries to commit to specific timelines. Thus, it will not be a good idea to lay out explicitly the timeline in Article IV staff reports as they may be published. It may not be politically and socially feasible for some countries to indicate a specific timeline to the public and this may deter countries from publishing the Article IV staff reports. Instead, it may be more beneficial to countries if staff could draw on their experience from various country projects to help the authorities to develop a systematic monitoring mechanism for the operations of public enterprises.

In connection with the criteria for assessing if public enterprises are commercially run, we welcome staff's re-examination of the appropriateness of the existing criteria in light of the finding that only 3 out of 115 public enterprises assessed in the pilot studies were judged to pass the test. We agree with a number of recommendations made by country authorities in the pilot studies on how the criteria may be refined such as the review of pricing policies for public enterprises operating in regulated sectors. We welcome the revised criteria proposed by staff and call for them to be tested appropriately. We have no objections to the revised criteria being tested in the upcoming Article IV missions in a sample of representative sectors as long as it is conducted on a voluntary basis. However, we remind staff to be cautious in reporting back the results to the Board in the Article IV staff reports. We are of the view that the results will be more meaningful if they are consolidated in a single report where general, inter-regional and intra-regional trends and comparisons can be done analytically. In addition, single country or isolated results reported in the Article IV staff reports may be misinterpreted by readers since it will be an incomplete information set and any meaningful or useful economic interpretation of the results can only be derived from a relative comparison between countries or with a 'model' or 'benchmark' country.

We take note of the staff's findings that a sound legal framework and a well-informed decision making process will help improve the efficiency of PPPs. We are of the view that technical advice on how to improve the technical capacity of the decision making in PPPs such as through the preparation of a public sector comparator which indicates the cost of public provision may be useful for some countries that are considering adopting a PPP approach. In addition, we agree with staff's view that PPPs should be used as a vehicle for transferring the risks from the government to the private sector and not be exploited for the purpose of moving public expenditure off the budget books. However, we are rather hesitant to endorse staff's proposal to adopt a comprehensive disclosure requirement for PPPs because it could lead to a disclosure of confidential business information of the private sector. As some of the contractors may be non-listed companies, this requirement may put them at a disadvantage relative to their competitors. As for inclusion of PPPs in the DSA, we agree in principle that government liabilities from PPPs should be included in the DSA. However, in practice, it is not an easy task to project accurate government liabilities from PPPs due to the complexities of such contracts and possible capacity and technical constraints. A negatively biased forecast would imply that the authorities would have less resources at their disposal than in reality. In that case, it may lead to an under-utilization of government resources.

Mr. Alazzaz submitted the following statement:

I thank the staff for a well-written and insightful set of papers. The findings from eight pilot country studies on public investment will carry forward the work on the design of fiscal policies which will be relevant not only for Fund-supported programs, but also for surveillance. I note that, in most pilot countries, private investment has fallen along with public investment in recent years. This is a concern, especially as there are significant needs for investment in infrastructure and for maintenance to help address bottlenecks that hinder growth. This raises the interesting issue of whether less tight fiscal policies with the additional spending going to highly productive investments in infrastructure would have been a more optimal solution in some cases.

When this topic was discussed last year in the Board, it was agreed that fiscal adjustment, including under Fund-supported programs, may have contributed in some instances to insufficient spending on infrastructure, at least in the short run. Moreover, it was also agreed that infrastructure gaps may be an impediment to growth. This latter finding is supported by empirical studies which suggest a positive impact of infrastructure projects on GDP growth for developing countries. Another study also concluded that a significant reduction in longer-term growth prospects in Latin America resulted from reductions in infrastructure spending in the 1990s. However, the empirical evidence in the staff's paper did not show unambiguous evidence of positive correlation between public investment and growth over the last decade in the pilot countries.

Given these mixed findings, it is essential to undertake further work not only to explain the differing results, but also more importantly to better understand the relationship between public investment and growth. Indeed, this is essential to improve the overall composition of public spending under existing financing and absorptive capacity constraints. While a better understanding of the linkage is important for the Fund's work, a thorough examination of the impact of infrastructure investment on growth appears to fit more with the mandate and expertise of the World Bank.

I agree with the conclusion reached in the paper that policy options for increasing public infrastructure spending by relaxing the fiscal stance are limited, particularly in countries with relatively high levels of public debt. Also, in view of the strong negative correlation between gross public debt and sovereign bond ratings, further spending if financed by additional debt could result in higher borrowing costs. Therefore, it is sensible to create the room for increasing public investment in infrastructure through an increase in the current fiscal balance and/or through a well-structured public-private partnership (PPP) program. In this connection, the staff rightly emphasizes that apart from maintaining the emphasis on the overall fiscal balance and gross public debt, a complementary focus on the current fiscal balance is also needed.

The pilot studies have provided useful lessons on policy options for improving the current fiscal balance. In countries with an already high tax effort, it seems appropriate that the focus should be on reducing current expenditure. In countries with a comparatively low tax effort, an increase in the current fiscal balance should be achieved by a combination of tax and expenditure measures. In low income countries with urgent spending needs in the education and health sectors, both infrastructure investments and appropriate current spending should be accommodated to accelerate economic growth. In all cases, however, it is essential to improve the efficiency and quality of infrastructure spending through better public investment planning and project evaluation. To help address this issue, the World Bank and other multilateral development banks should continue to play a key role in strengthening capacity in these areas through technical assistance and training. Adequate priority should also be given to the maintenance and rehabilitation of existing infrastructure.

Turning to the coverage for fiscal indicators and targets, the general government should clearly be covered. The issue of coverage of public enterprises (PEs), however, is less apparent. In the paper, the staff suggests a revised criteria to identify PEs that can pose fiscal risks by their operations. The staff also emphasizes that the revised criteria are more demanding analytically and informationally than the criteria tested in the pilot cases. Indeed, the revised criteria are much more onerous in terms of data requirements and will necessarily take considerable time for many countries. For example, just to meet the data requirements of one of the five criteria, namely, financial conditions and sustainability, industry-wide average cost of debt, debt-to-asset ratio, ratio of operating balance to assets, etc. will be required for each PE. Compiling and analyzing these data for all industries at the national and sub-national levels in which the PEs of the country operate are going to be extremely burdensome for the staff as well as for the authorities. Similar difficulties may be encountered in respect of other criteria listed in Box 3 of the paper. Staff comments are welcome.

Also, no clear procedure has been proposed on how conclusions will be reached on the fiscal risk posed by a PE. For example, if the assessment of financial indicators of a PE is very positive but the average price of traded goods/services for this PE is more than 10 percent below the relevant international benchmark (thus not meeting the requirement under the pricing policy), will the PE be judged to pose fiscal risk to the country? There can be several such scenarios. Indeed, a lack of a clear approach might lead to inconsistencies in the assessments for different countries and different PEs in the same country. Staff comments are welcome.

Another important consideration is that in many cases fiscal risks stemming from implicit guarantees to private sector companies that are deemed "too big to fail" could be higher than risks posed by PEs. Indeed, we have seen numerous bailouts of financial institutions and other private companies in the advanced, emerging market, and developing economies in recent years. Staff comments are welcome.

In terms of resource implications, the paper states that significant additional staff input would be required and should be budgeted for at the outset. Based on the experience of conducting the assessment of the commercial-orientation of public enterprises in the pilot countries, can staff provide a rough assessment of the staff resources that would have been required if the assessments were done based on the revised criteria? How does it compare to the commercial-orientation exercise? Before introducing the revised framework to future Article IV consultations, it is essential to fully understand the implications as well as additional burdens that will be placed on staff and authorities.

I welcome the increased recourse to PPPs in promoting the private sector supply of infrastructure assets and infrastructure-based services. This could ease the pressures on the fiscal accounts while offering the prospect of sizeable efficiency gains and improved growth performance. The case studies have provided useful lessons for the countries that are planning to embark upon PPPs. A sound legal framework and well-informed decision making are obviously essential requirements. It is also essential to ensure that the risks and costs of PPP projects to the fiscal accounts are clearly identified and accounted for. The valuation of guarantees as a financial instrument is clearly demanding in terms of technical capacity and information requirements and would not be practical for every country going for PPP. The case studies also point out that there is no unique approach to set aside funds to meet the expected costs of guarantees. It seems reasonable that if the debt sustainability analysis (DSA) indicates significant risks being entailed by a proposed PPP program, the imposition of a cap on the overall size of the PPP could be considered in program conditionality.

Mr. Schwartz and Mr. Calderón-Colín submitted the following statement:

We welcome the finalization of the pilot country studies which encompass an important effort to further understand the main reasons for the fall in public investment, to consider a macroeconomically responsible mechanism to compensate such decreases, and to attempt to establish some common methodology in the treatment of PPPs. Though comprehensive, results are in line with those expected and the analysis shows that much has still to be done in a new field—at least in terms of depth—of public finance. It will take some time before a comprehensive and commonly agreed consensus on the matter will be achieved, but the pilot studies are an important step to broaden our understanding in this issue. However, in some aspects the papers do not elicit sufficient light on the way forward.

The pilot studies conclude that there is not much room for additional infrastructure spending and calls appropriately for an increase in domestic savings based on responsible fiscal measures, such as expenditure prioritization and, where necessary, a permanent rise in tax revenues. Consistently, there is less room for those economies with large vulnerabilities and debt burdens. We totally agree that additional room for public infrastructure spending cannot be created by changes in fiscal accounting and consider that there is much to be done in terms of fiscal improvement. Finding additional room for public investment is, however, particularly important for those economies with a lag in this area, but that are engaged in a program with the IMF thus subject to fiscal targets and conditionality. What would happen in case a country has no longer a program with the Fund? Would the market or the IMF consider an increase in public investment (appropriately accounted for) as a bad signal? Staff's comments would be welcome.

There is disappointment with respect to the impossibility to carry a thorough examination of the impact of infrastructure investment on growth. This is a key issue for many members and a more comprehensive answer to this question would have been very useful. In our opinion some resource constraints could have been alleviated by assigning priority to this issue, as well as by receiving support from other departments, like Research. We call on staff to continue their work in this area.

It is regrettable that there continues to be such a significant difference in the coverage of national fiscal statistics across membership. In many countries fiscal accounts do not consider most of PEs and thus do not produce figures comparable to those of members that do include them. Evenhandness in surveillance is one of the main pillars of this institution and should be sought comprehensively. We would like to know what the concrete plans for addressing this shortcoming are. Is there a calendar with specific steps and deadlines envisioned? How long would it take to diminish significant differences in coverage among regions?

The criteria used in the study to determine whether a PE is commercially run are too stringent, as acknowledged by staff. If only 3 out of a 115 PE assessed pass the bar, it means that the latter may be set too high. In this vein, we agree with the authorities' suggestions to refine the criteria. Could staff tell us what Table 9 of the report would look like discounting for problems in managerial independence? Would it be acceptable? On the other hand, it is not clear whether countries will have the right incentives to exclude from the fiscal accounts the supposedly "commercially-run enterprises." From an aggregate point of view, these specific firms are the ones that cover all the fiscal inefficiencies that the rest of the public sector might have. By excluding these enterprises, the fiscal accounts might actually look worse. It is not clear who the advocate for considering the enterprises as commercially run would be. We would like to hear more on the criteria set by EUROSTAT to allow to record as private investment PPPs, thereby transferring some risk to the private sector and if other members would comply with it.

As staff notes, there is currently no internationally-accepted general accounting and reporting standards for PPPs and it is regrettable that no progress was made on this issue. This is not enough of an argument to suggest that fiscal accounts should incorporate all possible eventualities and contingencies. We understand that PPPs could entail some risks, but considering 100 percent of the risk, asking governments to cover that risk, and setting caps is truly exaggerated. Perhaps the Fund could in turn try to work on a more realistic and less draconian methodology, but a more "balanced" one to assess the risks. Modifying guidelines and affecting surveillance and conditionality when so little is known appears as extreme.

Instead of focusing on the transfer of risks to the private sector it would be important to make sure that the design of the contracts includes the necessary incentives to guarantee that all the efficiency gains will be achieved, which would result in transferring part of the risk to the private sector. Contracts with these characteristics would also minimize possible fiscal contingencies. However, it is also worth to keep in mind that the higher the risk transferred to the private sector, the less attractive a project may seem. We agree that known costs of projects should be included in the DSA, but would caution against the inclusion of potential future costs and strongly oppose counting future payments as future primary spending source. Before that, it is imperative that staff develop methodologies to include possible costs. Contingent costs depend on aleatory events and assigning cost to the highest possible contingency would be extremely pessimistic and, from the budgetary viewpoint, would eliminate the advantages of this scheme. A first approach might be to include all the monetary flows, including known income and expenditure and, as part of a sensitivity analysis, the impact of known potential costs, clearly establishing the circumstances under which these could materialize and the probability of them actually taking place.

Mr. Padoan and Mr. Gola submitted the following statement:

"Frontier Issues"

We thank the staff for their very effective effort in developing a conceptual framework and several suggestions along the line of the last Board meeting on public investment and fiscal policy. This set of well written papers looks at a number of very important issues which have a major impact on the Fund's policy advice. The issues raised in the papers are "at the frontier" in more than one way: because they raise difficult questions for which definitive answers are not yet available, including the very delicate point of determining ways to identify priorities in public spending in terms of their effectiveness and complementarity with private investment, and the issue of how to improve the quality of public finance and adjustment, which in the past have led to the deterioration of public investment. The papers also raise the issue of the frontier of the mandate of the Fund (also given the relevant implications for Fund resources candidly and appropriately raised).

Investment, Growth and the Inter-Temporal Budget Constraint

Countries with better fiscal positions, more developed financial markets and better regulatory frameworks, should be allowed to take advantage of some "inter-temporal trading," so as to disjoin, to some extent, (public) investment from national saving. In this context, the IMF's main objective is to provide an assessment on the amount of public saving required to support growth with additional public expenditure. Quantitative methods, such as DSA complemented with a great deal of "judgment" should guide the Fund on this difficult task. As noticed by staff, "policy options for increasing public saving depend on country-specific circumstances" (para. 23, p. 23).

The focus should be on: 1) how many resources for public investment are compatible with countries' budget envelopes; and 2) what are the costs and the "contingent liabilities" of alternative policies, such as PPPs.

The Fund's Comparative Advantage

Promoting macroeconomic stability and balanced growth, through appropriate instruments such as DSA, is one of the key missions of the Fund. Within this framework, both the debt dynamic and the evolution of the "denominator" (the rate of growth of GDP) are equally important. Assessing the effects on growth of the quality and composition of public expenditure packages, including public investment, is certainly within the objectives of the Fund. However, as underscored in the IEO report on fiscal adjustment, "since the IMF does not have expertise on social sector issues, nor is this is an area of its comparative advantage, input from other agencies, especially the World Bank (and possibly also others), are critical."[1] To reiterate the point, while making DSA more detailed and robust by including information on the implications of public investment is certainly in the core mandate of the Fund, looking into the details of specific public investment projects is in the mandate of other IFI's including regional banks.

The "Optimal" Amount of Public Investment: a Difficult Judgment

On the optimal amount of public investment, several considerations point to skepticism in assuming a standardized policy framework. A case-by-case approach seems much more appropriate. Countries with different levels of economic and institutional conditions could have very different "optimal" ratios of public investment to GDP. Therefore, the comparison between countries with different economic structures, patterns of trade, geographical configurations, etc., can be misleading. We are of the view that - once the fiscal macroeconomic framework has been defined - only a detailed cost-benefit analysis can offer a ranking of alternative use of public resources: while in some circumstances it is

[1] IEO, *Fiscal Adjustment in IMF-Supported programs*, 2003, p. 59.

better to increase public investment, in others, higher expenditure on other items (for instance in health, security or education) could be more appropriate. It is the primary role of the World Bank and other development institutions to provide an analysis, based on a full set of quantitative and qualitative indicators aimed at improving the quality of the expenditure and the best sequencing in implementing different projects.

The Fund should coordinate with the WB and other development institutions adequate procedures and guidelines, so as to receive from the WB timely and comprehensive information in order to assess the effect on growth of countries' fiscal policy. These institutions might also play a key role in assessing the financial feasibility of projects and help authorities to figure out what financial risks are and how to deal with them. Some experience, in this area, can be grasped from the current role played by the EIB in identifying the Pan-European projects which are deemed to be able to raise the growth potential of the EU economy, taking into account the financial feasibility of each project and outlining the most appropriate financial mechanism on a case by case basis. However, ultimately, setting priorities is a problem which should be left to the countries' authorities.

The Fund should help countries develop the capacity to assess priorities in public spending. However, the Fund should not become involved in microeconomic assessment of the best use of public resources. We recognize, in addition, that there is merit in the idea of supporting the qualitative judgment of a country's potential growth and debt dynamics with econometric and quantitative analysis on the relationship between public expenditure and growth. Given the formidable theoretical and empirical problems, the analysis should be limited to countries of the same region, so as to avoid excessive institutional differences (more difficult to quantify).

On Fiscal Indicators and Targets, the Fund Should be Focused on Fiscal Risks

We recognize that inadequate coverage of the transactions of public enterprises (PEs) in the fiscal accounts can be a source of potential financial risks. In some countries, PEs undertake quasi-fiscal activities without appropriate and transparent compensation through the budget, as pointed out by the staff. Also in this area the Fund should remain focused on the budgetary implications of potential fiscal risks and coordinate with the WB adequate procedures and guidelines in order to assess countries' fiscal risks. Particular attention should be given to the internal and external auditing standards of the major public enterprises, especially in the energy and natural resources sectors.

Public-Private Partnerships: Costs and Benefits

Public-Private Partnerships are a promising instrument to minimize both market and government failures. However, despite the apparently great success of the instrument and the increasing literature on this issue - including the recent well-written paper by FAD[2]—we remain convinced that further analysis is needed in order to provide a strong microeconomic foundation to this instrument. This is not an academic exercise: a better understanding of its characteristics is crucial to implement a policy framework which contemplates a wide range of alternatives, from full privatization (complemented with regulation) to public ownership. The set of possibilities should include a modern and more dynamic management of public enterprises. If well organized, public enterprises can be a source of revenue for the public sector, limiting the negative side effects of natural monopolies (just to give an example): designing a full set of contractual relationships, incentives, accountability procedures, etc. for a public enterprise is certainly not too complex or more difficult than building a PPP contract. As for the implications of program design, we agree with the point raised in paragraph 53 of the main paper that for countries under a Fund supported program a cap on overall size of PPP should be included in program conditionality.

a) The Benefits of PPPs

"*Organizations are a means to obtain benefits from collective actions in situations where the prices system does not succeed.*"[3] PPPs could be a useful instrument to organize the market, when the private sector, despite having financial resources and technical capabilities, does not or cannot supply a good or service for which there is a public demand. Through the PPP, the "public hand" is trying to organize market resources in order to mach the supply and the demand for a specific public provision (not necessarily a public investment). In this respect, PPP is not necessarily a substitute for other policies aimed at providing a second best solution in cases of market failures (natural monopoly, externalities, etc.). When the public debt is very high, PPPs can be one of the few ways to "catalyze" resources for projects of public interest. When the level of revenues on GDP is very low, the authorities should always consider alternative way of financing, widening the tax base and improving administration.

b) The Costs of PPPs

The international experience on PPPs is mixed. While there are success cases , there are also situations in which either the public side or the private side failed in achieving their objectives. We see, in particular, four sources of risk: 1) legal risks (because contracts are not fully specified or are not enforceable); 2) risk of renegotiation; 3) contingent liabilities; and 4) risk of bankruptcy of the private side. This last case can be a problem (possibly also a political one) for public authorities even if such an event does not imply a cost for the government. In this case, the temptation of bailout is very high. Ex ante political commitments

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[2] Public-Private Partnership (SM/04/94).

[3] K.J. Arrow, *The Limit of Organization*, Fels Lectures, Norton Co., New York, 1974.

are important but insufficient. When ambitious projects are involved (and the social and economic returns are very uncertain) it is advisable to assume a reasonable margin of error, so as to minimize the risk that the project does not provide a "normal" rate of return to the private sector. Symmetrically, the public side should carefully avoid contracts which imply rent-seeking behavior by the private partners. On this issue, it should be interesting to know from staff how frequent, on the basis of the international experiences on PPP, are cases of bankruptcy of the private partners and when the government intervened for the bail-out..

Government Guarantees and Financial Risk

Regarding the excellent paper on government guaranties, we limit our comments on the contingent liabilities related to the use of PPPs.

a) Public guarantees can be an effective response to the inability of the market to distribute risk optimally. In some specific circumstances the government can control better risks also because, in some cases it affects the risk itself (a problem which seems not fully recognized in the staff papers).

b) When possible, implicit guarantees should be made explicit. If this is not possible, the contingent liability should be contrasted through adequate provisions.

c) When valuation problems are high and market imperfections more frequent, public guarantees should be limited: the private sector should be left bearing the risk. This is particularly true when: 1) it is difficult to estimate the probability of default; 2) the guarantees are used in order to avoid forms of spending which are more subject to budget scrutiny. Modern financial techniques, developed for instance for credit derivatives, should, in perspective, reduce these problems.

d) We support the procedures suggested in the paper. In particular the necessity of improving transparency and financial reporting, the centralized control of the guarantees, the use of fees, so improving incentive and reducing moral hazard, the definition of quantitative ceilings to contain potential costs.

e) The staff paper shows very clearly that under accrual accounting, international accounting standards require that a contingent obligation should be recognized as a liability only where it is judged more than 50 percent probable that a payment will be made. In this case the budget should recognize the expected cost as a liability at the time guarantees are issued. The main problems emerge under the cash accounting. In this case, if the provision is not made, the potential cost is recorded only if the negative events occur and a cash payment is made. It should be interesting to know from staff: i) approximately, how many countries particularly involved in PPPs still use the cash accounting?; ii) how often are PPP projects complemented with precautionary provisions?; and iii) is the 50 percent criterion not too permissive in cases of very important projects, whose potential costs, in case of a negative event, is of some point of GDP? Staff comments are welcome.

f) Judgments about debt sustainability are not independent of the Government's non-debt obligations that rise nondiscretionary spending and constraint fiscal policy, as noticed by the staff. We are therefore in favor of including PPP and other government obligations in the DSA. We encourage the authorities to become more involved in PPP projects, or other instruments that implie explicit or implicit guarantees to improve the set of the information and the monitoring, so as to facilitate the valuation of the risk through modern techniques, as suggested in the paper.

In conclusion, we believe that, on the basis of an agreed and transparent framework, governments should provide estimates of the contingent liabilities on a yearly basis so as to improve the transparency of the overall fiscal position. The process should also be integrated with ROSC on fiscal transparency.

Mr. Kanaan and Mr. Shbikat submitted the following statement:

We thank staff for a thoughtful set of papers which draw some important lessons on options to accommodate public investment in fiscal targets and indicators, criteria to assess the commercial nature of public enterprises, and the fiscal implications of PPPs. These should prove useful for improving the Fund's surveillance and policy advice in the fiscal area and program design in general. As we have stressed on past occasions, consultations with member countries and staff reports should adequately and systematically address the quality of fiscal measures and the composition of expenditure, with an emphasis on those components most conducive to growth, to complement the current heavy reliance on the assessment of the magnitude and pace of fiscal adjustment. We broadly agree with the staff's assessment and recommendations, and will focus on some practical issues of implementation.

It is unfortunate that the pilot studies were inconclusive with regard to the relationship between public investment and growth, especially given that a presumption of a strong relationship, including through the complementarity between private and public investment, was the primary motivation behind the pilot studies in the first place. It is important not to limit further research to the derivation of estimates from cross-country studies, for example based on the notion of a "catching up" with more advanced countries. The emphasis should also be on case studies aimed at bringing to the fore the extent to which a country's prospects could be improved through higher and more judicious public investment, taking into account that country's other constraints on growth and any special complementarity between public and other types of investment. In this context, it is important to cautiously interpret the finding, referred to by staff in the concluding section, that issues related to public infrastructure services ranked at the bottom of investor concerns in "investment climate surveys." The positive externalities from such public investment tend not to be captured in the profitability calculations of private investors (in contrast for example to the other potential "bottlenecks" mentioned in the paper, such as high tax rates or "corruption" through financial bribes), but could nevertheless raise the contribution to growth of private investment. The extent of that contribution could certainly be enhanced through better public investment planning and project cost-benefit evaluation.

We agree with the staff's view that options for significantly increasing public infrastructure spending, by relaxing overall fiscal balance targets, are especially limited for those countries with tight constraints related to macroeconomic stability and debt sustainability. Any such relaxation should be supported by a careful assessment of aggregate demand conditions, absorptive capacity, financing constraints and medium-term debt dynamics. However, it would have been useful for staff's analysis to also focus on the possibility that, insofar as public investment has a positive impact on growth, it also relaxes to some extent the medium-term macroeconomic stability and debt sustainability constraints. In addition, a better understanding and appreciation by donor countries of the longer run growth implications of public investment, and the policy conditions under which such investment could make an especially positive contribution, could itself encourage greater concessional financing for this purpose and thus help alleviate those constraints.

The criteria used in the pilot studies to identify commercially-run public enterprises may be unduly restrictive, as suggested by the low number of enterprises that met the criteria. The proposed modification, placing the right focus on fiscal risks posed by public enterprises, addresses the arbitrariness of the criteria and helps avoid their mechanical implementation. However, it is important for staff to develop guidelines to help in the assessment of "fiscal risk," with a view to ensuring comparability of treatment across both public enterprises and countries.

We agree with staff on the importance of gradually broadening the coverage of the national statistics to allow a closer monitoring of public enterprises, with industrial countries taking the lead. However, caution is needed regarding the systematic extension of the coverage of fiscal targets to public enterprises. There should be a clear prioritization with regard to the enterprises to be covered, with a high priority given to those which, by the nature of their operations and potential links to the budget, pose the highest fiscal risks. This is especially important in view of the capacity and data limitations in developing countries. There are also important issues and questions to be addressed, which should guide the process of integration. In particular, under what conditions could the broadening of fiscal targets, and the paramount objective of satisfying those targets, adversely influence the operation and finances of public enterprises? How should laws and regulations governing the relationship between the government and the public enterprises be amended to allow an effective coverage?

On the public-private partnership program, it is important that the disclosure of PPPs' costs and their incorporation in the DSA, as outlined by in paragraph 52, take a well-rounded view of costs and benefits, as suggested in Mr. Steiner's Gray statement. We do not support setting a cap on the overall size of the program and to include such a cap in program conditionality. The fiscal risk posed by PPPs could differ substantially from one PPP program to another and as such it should be addressed on a case-by-case basis.

We see an important role for the Fund, the Bank, and other MDBs in helping countries improve the composition of public expenditure and strengthen the institutional framework to assess and prioritize public investment. It would also be useful to draw on the findings of the pilot studies to design a reform agenda to help countries in the restructuring of public enterprises, with a view to making them more commercially oriented and reducing their fiscal risks.

Finally, many of the issues raised in the papers are subject to change in view of the ongoing reforms implemented by member countries, and will therefore need to be kept under review. The resource implications of this work could be significant and we look forward to the outcomes of the proposed pilot cases to provide an estimate of the cost of undertaking appropriate follow ups in Article IV missions. We also look forward to clear guidelines to staff to operationalize the recommendations outlined above, with a view to ensuring both rigor of analysis and an even-handed treatment across countries.

Mr. Silva-Ruete and Mr. Lopez-Escobedo submitted the following statement:

At the outset we would like to thank the staff for their insightful, well-written and comprehensive set of reports. While we concur with the thrust of the reports, we would like to comment on some issues.

The evidence regarding infrastructure spending, public investment and growth is interesting, but still preliminary to make a definitive assessment. The decline in public investment reflects a set of interconnected factors, such as a widespread trend towards a diminished government size and influence in the economy, and an increased private participation, however it is also a result of tightening financial conditions faced by governments and thereby the need of fiscal consolidation. We fully agree on the need and support further analytical and empirical work to evaluate both the size of public infrastructure and rehabilitation needs as well as the channels through which public investment affects economic growth. We offer two suggestions for future steps to deepen the understanding of such relationship. On one hand, given that the observed decline in public investment has been in part the natural outcome of privatization and of the opening up of different sectors to private participation in the course of the 1990s, we believe that it is an interesting avenue to focus future research and analytical efforts. On the other hand, we consider the work should also focus on the analysis of the quality of investment carried out by the public sector. In particular, future studies should concentrate on how the country's differences regarding their mechanism of selection and resource allocation to investment projects may explain their differential impact on growth. In Chile, this connection appears to be highly relevant provided that the project execution must fill the required social return substantially higher than the government's marginal cost of borrowing.

In principle, it is important to bear in mind that due to its nature of spreading externalities throughout the overall economy, for public investment to enhance growth on a sustainable basis, an adequate policy framework must be in place to effectively safeguard the efficiency of investment, while preserving macroeconomic stability and the sustainability of the public sector financial position. In this context, an adequate approach should therefore connect an assessment of the capacity of—private and public—resource mobilization to infrastructure areas with the need to preserve the sustainability of public sector financial position and macroeconomic stability. These considerations are particularly important given the high premium that international financial markets put on the sustainability of financial position of public sector of emerging economies and the likelihood of capital flows reversion in the current global environment characterized by widened imbalances among advanced economies.

Although we believe fiscal policy stance should be oriented to bring about an adequate aggregate demand control as a precondition for macroeconomic stability, and therefore, public investment should play a key part of this account, we find interesting the idea drawn by the staff that public investment should be consistent with a declining of debt-to-GDP ratios over medium-term in order preserve the sustainability of the public sector financial position. This proposal seems to be very close to the UK "golden rule" that requires the public sector's current balance to be non-negative on average over the business cycle and a sustainable investment rule requiring net public sector debt to be kept at a stable and prudent level—below 40 percent of GDP. We welcome the staff's deeper elaboration on this issue. In particular, we are interested in the merits and disadvantages of this asymmetric rule in boosting public investment in comparison to Chile's fiscal rule, which apparently would impose a more stringent fiscal discipline regarding overall expenditure.

In a context of limited financial resources, the involvement of private sector in infrastructure investment efforts is pivotal. The reports show striking evidence that governance issues are the most important factor affecting the decision and the scale of private sector participation in this area, and therefore, country authorities should be encouraged to improve investment climate through strengthening and perfecting institutional framework to accommodate an adequate private sector involvement. Likewise, improving quality and efficiency of public investment would require strong budgetary procedures within a institutional framework oriented to an appropriate prioritization, implementation and monitoring of public investment programs and project. Multilateral Development Banks should play a key role in providing technical assistance to membership.

In several paragraphs of the reports, it is indicated that in the investment project appraisal, fiscal returns—economic returns captured by government—should be assessed. However, we do not see a clear objective. We welcome the staff's comments on this particular aspect. To elaborate in such direction we believe it is important to make a distinction between government spending in social investment vis-à-vis productive assets. As far as government accounting, social investment should be classified as expenditure in the current balance, whereas productive investment should be classified as a non-financial asset acquisition in the capital account. In the same vein, investment depreciation should be considered as expenditure in the current balance. The advantage of these changes is that the government's accounting would be more coherent with the accrual based accounting, which would allow for a more solid analytical base to allocate resources between operational and investment spending and/or improve the debt sustainability analysis as government productive assets could be matched with net financial debt.

We welcome the modifications proposed by the staff in paragraphs 36–39 regarding the criteria for assessing public enterprises treatment in fiscal accounts with a shift focus to assessing their fiscal risk potential. In general, they entail an important degree of flexibilization in consolidating government and public enterprises accounts. However, we do not see changes in the category "relations with the government," which in our opinion is precisely where more adjustments are needed since it is of importance to enhance transparency of quasi fiscal activities of public enterprises. We welcome the staff's comments on this issue.

Although Public-Private Partnerships (PPPs) can allow greater private sector participation in public investment, increasing efficiency, enabling the public sector to spread costs and transferring risks to the private sector, the reports contain interesting evidence that it could be driven by desires to move expenditure off budget. In this venue, we suggest some practical distinctions or rule-of-thumb that could help in the classification of PPPs as public vis-à-vis private investment, thus allowing to identify the most common leakages to evade fiscal restrictions. For example, projects with investment exceeding 50 percent of net present value of contract and with fiscal subsidies covering more than 75 percent of financing could be classified as public investment.

Chile's secret of its success with this instrument resides on the strong and continuous improvement of the institutional framework for PPPs, with an orientation to reach higher disclosure requirements and compatibilize the size of PPP programs with contingent liabilities and other fiscal risks entailed in it. In particular, the project selection has been extremely conservative and revenues from these projects are demonstrating this. We agree that there are some areas which could be strengthened going forward (paragraph 33, SM/05/119). In fact, we have already moved forward in some areas. For example, on conflict resolution procedures, the Ministry of Public Works recently established a Board of independent professionals to deal with the Ministry's position regarding the arbitration panels. On the issue of project evaluation, public sector comparators are being developed for some public projects (e.g., prisons, judiciary buildings in Santiago, and a potential hospital concession). Regarding design and engineering specifications, the incorporation of changes proposed by contractors is being increasingly accepted. For instance, the recently completed Costanera Norte, an urban highway, was redesigned by the contractor.

Mr. Oh and Ms. Amador submitted the following statement:

Key Points

▪ There are very limited policy options for raising public investment spending through a relaxation in fiscal indicators, particularly for countries with unfavorable debt dynamics.

▪ Establishing the growth effects of public investment is critical for better informed debt sustainability assessments.

▪ Disclosure of information on the operations of public enterprises, PPPs and government guarantees is key to a comprehensive assessment of fiscal risks. Informational and technical challenges abound, however, and we encourage staff to work closely with the authorities in this area.

We welcome the opportunity to discuss lessons from the pilot studies on public investment and fiscal policy. We appreciate the high quality work done by staff, which we believe will contribute to strengthening the present approach to fiscal analysis and policy with a view to promoting public investment within a macroeconomically sound and fiscally-sustainable framework.

We agree with staff that policy options for increasing infrastructure spending through a relaxation in fiscal indicators or overall fiscal balance targets are limited, particularly for countries whose debt dynamics render them vulnerable to macroeconomic shocks. Fiscal space for raising public investment needs to be created first by raising public saving through expenditure prioritization and better expenditure management as well as revenue mobilization, with the appropriate mix of policy action depending on country-specific circumstances. Room for expanded infrastructure investment can also be made by creating an enabling environment for private sector participation. The pilot studies also reveal that there is considerable scope in raising the efficiency and quality of infrastructure spending through better public investment planning, project oversight and management. The World Bank and other MDBs should continue to assist countries in building capacity in these areas through appropriate technical assistance and training activities.

Still, some flexibility is introduced in guiding analysis of fiscal policy when the staff notes that, while the focus should be kept on the overall fiscal balance (and its impact on macroeconomic stability and debt sustainability), a complementary focus on the current fiscal balance can lead to a better assessment of the quality of a country's fiscal policy, especially when additional infrastructure investment is likely to generate higher returns in terms of growth relative to other types of spending.

Establishing the Output Effect of Public Investment

Practical guidance on how this complementary focus can be achieved is constrained, however, by the difficulty of pinning down the relationship between public investment and growth. Empirical evidence on the output effects of infrastructure spending is mixed, and it has been posited that a non-monotonic relationship exists between the two variables. In addition, while the availability of infrastructure services is clearly important (more so for some countries relative to others), the investment climate depends on a whole array of factors, including the tax regime, macroeconomic stability, governance and the economic policy and regulatory framework. We look forward to further analytical and empirical work on this complex subject, which we understand is being undertaken by both Fund and World Bank staff. A better understanding of the growth impact of infrastructure spending—including the channels through which it affects the growth process—will help inform policy discussions, and allow for better assessments of medium-term public debt sustainability. It would also be interesting to understand if and how weaknesses in economic infrastructure not only restrict the potential for future growth but also limit improvements in social welfare and poverty reduction. We also encourage staff to look more deeply into the issue of quantifying infrastructure gaps. In these activities, we stress the importance of securing the active participation of the authorities who are in the best position to determine the appropriate level of infrastructure spending in line with budget priorities and existing capacity constraints as well as consistent with debt sustainability.

Coverage of Public Enterprises in Fiscal Indicators and Targets

We support the staff's recommendation for a gradual extension of the coverage of national statistics, preferably in the GFSM framework, to all public enterprises. Appropriate disclosure of information on the operations of public enterprises would help in generating a comprehensive appreciation of the fiscal risks involved. We also share the view that the appropriateness of including public enterprises in fiscal policy indicators and targets should focus on the potential fiscal risks posed by individual enterprises. In this regard, we consider sensible staff's recommendation to determine the applicability of the suggested revised criteria to a wide range of circumstances by testing these in a representative sample of countries in upcoming Article IV consultations, and to report their findings to the Board. This will provide the authorities further opportunities to participate in the fine-tuning of the proposed revised set of criteria to diagnose fiscal risks.

Public-Private Partnerships and Guarantees

Under conducive conditions, the private sector can efficiently take an active role in the provision of economic infrastructure. An enabling regulatory environment and a sound legal framework that helps ensure the rule of law and enforceability of contracts and protect property rights as well as a well-structured framework for public-private partnerships (PPPs) are key in promoting a more dynamic role for the private sector in infrastructure development. Where necessary, credible regulation is also important in ensuring that a balance is observed in upholding the interests of the various stakeholders.

Like staff, we believe that there is considerable merit in diagnosing and capturing the fiscal risks created by PPPs. The known and potential costs for the government implied by PPP contracts need to be considered in assessing the robustness of the fiscal position, including the sustainability of the public debt. Staff presents sound arguments for disclosing the potential fiscal risks arising from guarantees and bringing them into the discipline of the budget process. A logical starting point in obtaining a more meaningful understanding of the fiscal impact of guarantees (specifically those provided in connection with infrastructure projects involving PPPs) is through appropriate disclosure requirements for guarantees as well as through centralized and effective controls over guarantees. However, the valuation of guarantees poses serious difficulties especially for those countries that lack the experience, technical expertise and the necessary information. We are also mindful that the practical difficulties of estimating the fiscal risks created by guarantees is particularly significant for those countries that experience large, unpredictable shocks and are subject to considerable structural change. We look forward to further staff work on this issue.

Where reasonably reliable estimates of the future expected cost of guarantees can be made, this should be brought into the discipline of the budget process, including assessments of debt sustainability. We agree that it is prudent to have more cautious debt sustainability assessments in countries with substantial guarantee programs. Absent robust quantification of contingent liabilities associated with PPPs, we agree that scenario analysis will be helpful in stress-testing baseline debt projections with respect to alternative assumptions about calls on guarantees. In this regard, we strongly encourage the staff to consult and involve the authorities in the setting up of scenarios with a view to obtaining a better handle on the realism of the assumptions used. Quantitative ceilings on guarantees appear sensible but this begs the question of what would be a reasonable limit to government guarantees. It would be helpful if staff can provide further guidance on country experiences in establishing ceilings on guarantees.

Staff notes that the recommendations contained in the paper will have considerable resource implications on the Fund. It should also be recognized that the initiatives identified by the staff will require parallel efforts from the authorities, given demanding information requirements that will be made on them. The compilation and monitoring of data on the operations of public enterprises, PPPs and guarantees will pose considerable challenges in data base building and management, and many countries will require targeted technical assistance to improve the reliability, comprehensiveness and timeliness of data on public investment.

Mr. Lushin and Ms. Vtyurina submitted the following statement:

The pilot exercise has delivered useful results, which should help the IFIs acquire better understanding of and demonstrate greater appreciation for the challenges facing public sectors in their member countries. We would like to concentrate our comments on the issues raised for the discussion.

Growth—Public Infrastructure Investment Nexus

As Messrs. Misra and Guaba and Ms. Phang and Mr. Wesaratchakit, we find the overall message in the paper (SM/05/119) to be somewhat biased towards the notion that there exists only little convincing evidence of the positive effect of public infrastructure investment on growth and private investment. This is apparently based on examining the existing literature on the topic (demonstrating mixed empirical results) and conducting investor surveys in four of the eight pilot cases (concluding that infrastructure bottlenecks were relatively mild drawbacks for private investment in a country). As Messrs. Kanaan and Shbikat, we would suggest a more cautious interpretation of the results of the surveys and the presentation of the overall message regarding the lack of "unambiguous evidence." In regards to the surveys, it needs to be recognized that the sample is small, and obviously the results also depend on the type of investor participating in the survey. Furthermore, this does not bode well with frequent attention paid to the importance of infrastructure for growth in Fund programs with LICs.[4] The limited number of country cases presented in SM/05/119, in our view, seem to point to the significance of infrastructure for private investment and growth, even

[4] e.g., as stated in Cameroon's Article IV Consultation report (EBS/05/56): "An increase in public sector investment will be essential to improve *basic infrastructure* especially in transport, communication and electricity supply that have been constraints on growth in the past." (para. 16) Furthermore, "sustainable private sector investment growth require that authorities to address *inadequate infrastructure*...." (para. 2 of Executive Summary).

if empirical evaluation did not derive clear-cut conclusions.[5] This said, it is rather obvious to us that, even without "unambiguous evidence," public investment in infrastructure is essential for growth in many LICs, developing countries and many emerging market economies.[6] Moreover, there are limited substitutes for public sector investment in many countries either due to a small size of the private sector or an unattractive rate of the return on investment, especially in the short-term. Therefore, we would be hesitant to wholeheartedly support further research on this topic, as suggested by the staff.[7] Rather, we see more value in utilizing the scarce resources in helping countries to improve their fiscal management, data collection and project evaluation with the end goal being greater productive public investment, a point also supported by Messrs. Silva-Ruete and López-Escobedo.

DSA

In justifying, perhaps, at times tough Fund's stance on members' fiscal capacities to increase public investment, it is most appropriate to highlight the interconnectedness of the macro economy, debt sustainability and public savings. This is not to say that this is easily done, given a definite tension between determining the appropriate level of sustainable debt and not overly restricting public investment and thus its effect on growth. In this respect, it would be necessary not only to display the results of the DSAs under various assumptions in staff reports but also to emphasize the limitations imposed by financing options (e.g., the availability of concessional financing). Moreover, we agree with the staff that, in principle, it would be beneficial to include in the medium-term DSAs the estimates of the effect of additional public infrastructure spending on growth. Yet, it is doubtful that this approach could be successful unless the identified problems with data reliability and measurement techniques are resolved. In this respect, we share the reservations regarding the robustness of analytical frameworks presented in paragraph 15.

Measuring Capacity for Public Spending

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[5] In fact, in the case of Brazil, a lucid connection has been established between the effect on the country's long-term growth prospects of the decline in public investment and the emergence of infrastructure bottlenecks (para. 8, SM/05/119). Ethiopia is an even more striking case, despite the staff's hesitation to rely on anecdotal evidence.

[6] "...the exchange rate is not the only determinant of the growth in exports [in China]. WTO accession, rapid productivity growth and good infrastructure have played key roles as well', according to Messrs. Prasad's and Rajan's article in the *Financial Times*, May 10, 2005.

[7] We would be interested in research done on a related topic on how those countries that are running primary fiscal surpluses during cyclical economic upswings can use the available funds for high quality infrastructure projects without unduly overheating the economy and adding to inflationary pressures.

In calculating room for greater public spending it is obvious that diverse conventional approaches could be applicable to various countries, depending on their individual fiscal positions and the composition of their fiscal accounts. In particular, we support an approach that concentrates on both overall and current fiscal balances to help gauge better the quality of fiscal policies. As previously, we also share the staff's views on drawbacks of (questionable) fiscal accounting changes to accommodate for larger infrastructure spending. Furthermore, we welcome the on-going efforts in making countries become aware of the importance of improving mechanisms for appraisal, selection, monitoring and implementation of public projects. TA from the respective IFIs would have the best value for money in this particular area.

IFIs Role

We do not see the need to rethink the involvement of IFIs in the area of public investment. While we encourage greater involvement of the Fund staff in assisting the authorities in improving fiscal management and facilitating greater productive public investment, we would prefer the Fund's role to be limited to assessing macro preconditions and conducting DSAs and staying the distance from any microeconomic issues, such as assessing the viability of particular projects, as also suggested by Messrs. Padoan and Gola. We hope that in the latter area the Fund can rely on the assessments made by its colleagues at other IFIs. That is, we would expect the World Bank's programs to target improving governance and management of public enterprises (PEs), for example, and together with other relevant IFIs provide loans for improving public infrastructure. To make this task distribution work for the best benefit of the member countries, coordination in information sharing between the IFIs needs to be improved.

Public Enterprises

The role of the Fund could be significant in helping countries to enhance the coverage of PEs in national statistics, possibly through GFSM 2001 framework. As there has been notable difference in requesting extended data from some countries but not from the whole membership, we would be prepared to endorse a gradual approach of extending such coverage to all members. At the same time, and as we have stated last year, this will not be an easy goal to achieve, given countries' different capacities in data collection and the legal status and reporting requirements of PEs, which subsequently makes it very difficult to gauge the PE's impact on the overall fiscal position.

As regards the criteria for determining the commercial nature of public enterprises, the pilot cases seemed to have delivered important evidence of the limitations of the originally proposed criteria. At the same time, we note that the revised criteria could result in an even lengthier analysis and require an even greater degree of subjectivity. The staff also propose to use the revised criteria by several Article IV consultation mission teams so that to gauge costs of the exercise. We are not convinced that this is the best approach. Not only will this entail significant resource costs (as showed in para. 61) but also the Fund area economists may not possess the appropriate expertise in all areas slated for assessment, like pricing policies, shareholders' rights, market access, project/investment analysis, etc. While, of course, the staff is fully capable of acquiring this knowledge, we do question the appropriateness of this exercise in the context of the Fund's mandate and limited resources. Finally, and as mentioned by Mr. Oh and Mrs. Amador, this will also necessitate substantial capacity from the authorities' side, which may be quite limited.

Based on the considerations presented in paragraph 39, we support the proposal for applying a flexible and a case-by-case approach to the consolidation of the operations of covered PEs with the general government when specifying fiscal indicators and targets.

Public Private Partnerships

We continue to share the staff's concerns regarding the lack of internationally accepted accounting framework and reporting standards for PPPs and the difficulties this creates. The staff, thus, did commendable job in searching for ways to make PPPs more transparent in the absence of standards. In principle, we could support the proposals in Box 4 if this strategy is applied across the membership. Since the DSA is specifically designed to incorporate scenarios and stress testing of different parameters, it could be an appropriate vehicle for incorporating contingent liabilities associated with PPPs, as suggested in paragraph 52 of SM/05/118. However, this also would be a time consuming task, requiring technical knowledge in the evaluation of PPPs from the area departments' staff and, most importantly, from the authorities. This will most likely not be possible in most LICs and developing countries, as even advanced countries with extensive experience with PPPs rarely evaluate their contingent liabilities through the discussed techniques (para. 21, SM/05/120). Furthermore, public sectors may be exposed to quite a few potential liabilities (deposit insurance and mortgage guarantees, capital injections, pension obligations, etc.).[8] Yet, there is no existing practice of including all of these in the DSAs. Therefore, as Mr. Steiner, we do not see it appropriate to include guarantees under PPPs into DSAs if other ones are excluded. At present, therefore, we suggest to concentrate on steps outlined on Box 4 on improving transparency in accounting for PPPs. Having said this, and given the uncertainties in estimating potential future costs of PPPs, it would seem too restrictive to place a cap on the size of the overall investment program (in the Fund program context) in cases when "DSA points to significant risks entailed by the proposed PPP program" (para. 53 of SM/05/118). Perhaps, it would be more fitting to include all the potential liabilities in a stand

[8] Could the staff elaborate on the method used to calculate full government guarantees of deposits in (some) DSAs (e.g., Uruguay)?

alone scenario within the DSA, or take a note of the approach suggested by Messrs. Schwartz and Calderón-Colín.

Mr. Bischofberger and Ms. Wolff-Hamacher submitted the following statement:

We welcome the comprehensive and interesting set of reports on public investment and fiscal policy. It is somewhat disillusioning, yet not surprising, that the empirical evidence on the impact of public investment on growth remains mixed. Staff points to the significant additional resources that a more thorough examination of the impact of infrastructure investment on growth in the pilot studies would have required. In view of this and given the Fund's limited resources and budget constraint, we would caution against further resource intensive empirical studies to be undertaken by the Fund. We support the view that such research would be primarily the task of the World Bank.

We agree with staff that many countries have limited scope for increasing public investment by relaxing fiscal targets. Especially countries with high public debt burdens will need to make room for more public investment by increasing public saving through expenditure reprioritization and, where appropriate, revenue mobilization. In this context, it is important to note that the World Bank Investment Climate Survey (ICS) indicates that private investment decisions may be more closely related to the strength of government institutions and policies than to the availability of public infrastructure per se. This is fully in line with the results of the investment climate surveys carried out in four of the eight pilot countries. We also agree with staff on the importance of improving project appraisal and implementation capacity. But again, this is an area where the Fund should not be in the driver's seat. We therefore support staff's statement that the "World Bank and other MDBs should continue to take the lead in assisting countries in strengthening their capacity to carry out these tasks."

We support staff's call for the coverage of public enterprises in national statistics within the GFSM 2001 framework in order to increase transparency. Regarding the coverage of public enterprises in fiscal indicators and targets we also support, in principle, shifting the focus from assessing the commercial orientation of public enterprises to assessing their fiscal risk potential. However, as staff notes, this approach is "likely to require significant additional staff input that has to be recognized and budgeted for at the outset." Thus, we support Messrs. Yakusha and Stucka's point that implementation in this area should be gradual and subject to prioritization.

On PPPs, while we agree with staff that, in general, project risk should be borne by the party that can manage it best, it is nonetheless the government's decision what risks are transferred to the private sector and what risks are borne by the government, even if this may result in more guarantees. A realistic assessment of the fiscal risk posed by guarantees then is essential. As staff notes, techniques to estimate the expected value term of a contingent liability are available, and are for example successfully applied in Chile and Colombia. However, in many other countries data quality and technical capacity are currently not sufficient to support the application of these techniques. Here, technical assistance from the World Bank seems warranted. We support staff's recommendation for transparent accounting practices regarding PPPs and the inclusion of contingent liabilities associated with PPPs in DSAs. Where contingent liabilities cannot be realistically quantified, stress-tests should be included in the DSAs. If the DSA points to significant risks related to specific PPPs, the imposition of a cap on the overall size of guarantees seems appropriate. A more flexible approach could be envisaged when countries have set aside funds to meet the costs of called guarantees.

Mr. Kiekens and Mr. Veziroglu submitted the following statement:

We thank the staff for the interesting and informative papers which will contribute to today's discussion.

While the theoretical literature is reasonably clear about the relationship between public investment and growth, the empirical literature and the staff papers are still ambiguous about the direction and the strength of the relationship. This is puzzling. However, given the strong theoretical arguments for a positive significant effect of public investment on economic growth, we accept the view that selective and prioritized public investment does have a strong direct impact on economic growth. The composition of public investment is also important for promoting growth.

We believe that for countries it is more important to have a stable and sustainable growth rate rather than just a high level of growth. Although pilot studies suggest that countries could maintain high growth rates, a striking feature is the increase in their volatility. The main source of instability in countries is the stop and go pattern of the policies which result in high levels of discretionary spending, high inflation and rising external debt. Therefore, the Fund should continue to focus on the overall fiscal balance as a fiscal indicator or as a target for protecting macro stability and debt sustainability. Countries should design and adjust policies to protect productive investment from the effects of fiscal consolidation.

Under significant fiscal policy constraints, countries are left without any choice other than prioritization of expenditures in order to raise the allocations for priority sectors and increase public investment. Countries need to introduce measures to strengthen assessment and control of total resources, the budgetary framework and resources, expenditure prioritization and project evaluation. Meanwhile, efforts to mobilize domestic resources through more broad-based tax reforms are equally important to maximize the development impact of public investment.

Governments may take a number of opportunistic budgetary and accounting actions to meet their deficit and debt targets. Public Private Partnerships are the most attractive framework for this purpose. Countries should be very cautious in transforming their role, moving from directly providing and financing services to guaranteeing that the private sector will achieve certain outcomes. Initially, it might be seen feasible for governments to outsource their responsibilities and to encourage private sector initiative through explicit or implicit government guarantees, but eventually this may leave governments with increasing uncertainty about future public financing requirements.

Previous experience clearly shows that governments have incurred expenditures above envisaged limits following a massive failure of projects covered by state guarantees. Governments should be required to assess and compare the full cost of alternative budgetary and off-budget programs and to report all contingent liabilities and other fiscal risks. While educating key policymakers, opinion leaders, and the public is essential, increasing awareness of fiscal exposures is not enough. Effective implementation of fiscal surveillance with respect to contingent liabilities depends on the willingness of governments to publicize relevant information. To create incentives to better support sound decisions about how to finance or avoid such exposures, the Fund will need to encourage the development of accurate cost measurements and their integration into financial reporting, budgeting, and other policy processes. We concur with the staff that inclusion of contingent liabilities into the Debt Sustainability Analysis would provide a bigger and clearer picture, making possible a better assessment of the risk.

Large fiscal operations outside the central government budget, including numerous state-owned enterprises with quasi-fiscal operations would call for assessing the fiscal risk.

A more detailed framework that includes both the policy and institutional aspects associated with fiscal risks and use of this analytical framework to assess it is an appropriate avenue to explore. While we consider worthwhile the staff's proposal to use new and innovative approaches, like applying value-at-risk methodology for the fiscal accounts, we believe that the literature in this area is still premature and institutional capacity together with the data and transparency problems in countries would make the exercise more challenging. Meanwhile, the staff should also carefully consider the level of experience and expertise of the Fund in this area and seek to increase its own technical capacity.

While commercially-managed public enterprises should be excluded from the overall fiscal balance, governments should report regularly on their finances. Hence, we support the proposed gradual approach to extending the coverage of public enterprises in fiscal indicators and targets. We also support the revised criteria proposed by the staff which would bring more flexibility and ensure that more public enterprises could meet this criteria.

The Fund's technical assistance will play a key role in this process. It is obvious, and the staff also confirms, that to assist countries to reform their analytical, policy, and institutional public finance frameworks to address all major fiscal risks would require enormous resource allocation. Budgetary constraints should be taken into consideration and we should refrain from increasing the already high burden on borrowing countries.

We support the publication of the set of papers.

Mr. Wang and Ms. Wang submitted the following statement:

We thank staff for the comprehensive papers, which draw some interesting lessons from the pilot countries undertaking public investment studies. We believe the studies will help further thinking on ways to increase public investment in infrastructure while safeguarding macroeconomic stability and debt sustainability.

Public Investment and Economic Growth

We note that contributing factors to the decline of public investment include a decline in public saving, fiscal consolidation, and a growing preference for a smaller public sector. Most of these are not one-off factors. For example, countries with high debt levels will have to continue fiscal consolidation while countries experiencing declining public saving will have to undertake further structural reforms to increase saving. Therefore, many countries will still face the pressure of declining public investment in the future and the challenge of increasing public investment, especially to enhance the efficiency of the investment and its contribution to economic growth. It is noteworthy that declining public investment has not been offset by higher private investment. The slowdown of economic growth in some pilot countries in recent years may not only be due to the decline in public investment, but also to private investment.

The absence of unambiguous evidence on the relation between public investment and growth in the pilot countries could be attributed to the following reasons. First, public investment infrastructure projects may have a one-off impact on current year GDP by increasing aggregate demand, but if some projects are not chosen appropriately or are poorly managed and running at low-efficiency, the multiplier effect of the investment on economic growth is limited. Second, problems with the accuracy and comprehensiveness of the available data on public investment have underpinned the analyses. Third, the effect of some public investment on economic growth may be indirect and not easy to quantify. But we note that the positive impact of public investment on growth tends to be more robust for developing countries. We believe that infrastructure projects funded by public investment will—both directly and indirectly—affect sustainable economic growth in developing countries in the long-run while infrastructure bottlenecks will, to some extent, hamper the growth potential.

In further research, staff might take a look at those countries where the relationship between public investment and economic growth is significantly positive. On the other hand, staff should also pay attention to other factors which have an impact on economic growth in those countries with high levels of public investment but where economic growth does not perform well. The impact of public investment on productivity is also worthy of research. The paper points out that the magnitude of infrastructure investment needs remains uncertain in the pilot countries. The results using the "catching-up" approach and that which looks at the demand for infrastructure associated with different assumed GDP growth rates are quite different. Both these approaches to measure infrastructure investment needs have abstracted from resource and absorption capacity constraints. A preferable approach mentioned in the paper—an assessment within a macroeconomically sound and fiscally sustainable framework—is worth exploring further and an appropriate level of public investment in developing countries to achieve a reasonable economic growth rate may be decided.

Ways to Increase Public Investment

The paper lists different policy instruments to increase public investment in infrastructure. We note that many countries have limited scope for increasing public investment by relaxing overall fiscal targets. We share staff's view that increased public saving is required to create room for additional public investment. Policy options for increasing public saving depend on country-specific circumstances. In most cases, a durable increase in public saving can only be achieved through fiscal structural reforms which will take time. So it is important to prioritize expenditure and strengthen expenditure management. And in the case of low-income countries, a careful balance should be made between current spending and infrastructure investment. We also agree that governments seeking to increase public investment faster than public saving should ensure that macroeconomic sustainability is safeguarded.

To ensure that new investment is productive, we agree that project appraisal and implementation capacity should be strengthened. The paper summarizes some important lessons—allocating budgetary resources efficiently, monitoring projects under execution and evaluating them ex post, and investment planning in low-income countries. In the meantime, it is important to ensure that current projects can be finished on time and generate economic benefits, rather than rushing to new projects. The MDBs could play an important role in these areas through technical assistance and training activities.

We note that tax issues and policy uncertainty, rather than the availability of infrastructure services, topped the list of private investor concerns in a number of the pilot countries. In this regard, we fully agree with staff that there is a need to strengthen the policy and institutional frameworks affecting private investment in many of the pilot countries. And the longer-term effects of public infrastructure spending on growth will largely depend on the extent to which other key concerns of potential private investors are addressed.

Public Enterprises

In principle, comprehensive coverage of public enterprises in national statistics will help increase the transparency of budget implementation and reduce potential fiscal risks. However, we should take into account the circumstances of each country. Given existing data and capacity limitations in many countries, this process is likely to take time. Therefore we emphasize the gradual approach to extend coverage of public enterprises in fiscal indicators and targets. We also share the view that the decision on whether fiscal reporting and monitoring and fiscal indicators and targets, should focus on the consolidated public sector, or the general government and public enterprise sector separately, is one that should be taken on a country-by-country basis.

The results for assessing public enterprises on the basis of the criteria adopted at the last meeting show that there may be some ways in which the criteria can be refined. We agree with the proposed shift of focus from assessing the commercial orientation of public enterprises to assessing their fiscal risk potential. We view the revised criteria as generally appropriate; however, as the revised criteria are more demanding analytically and informationally, staff should not apply them mechanically. The future practice of applying the new approach could provide the basis for better judgment of the fiscal risks posed by individual public enterprises, and for a more appropriate decision on their inclusion in fiscal indicators and targets.

PPPs

Several countries have used PPPs to foster private investor's participation in infrastructure projects. However, PPPs are no panacea and should not be used for moving expenditure off budget. We full agree that PPPs are likely to be more successful in fostering private sector investment in infrastructure when the institutional framework is well developed and when proper accounting practices and transparent disclosure requirements are in place.

Regarding the quantification of potential costs arising from guarantees provided to the private sector under PPPs, it is important to take into account the lack of data and capacity in many countries. On whether or not to include PPPs and other government obligations when assessing debt sustainability, we share Mr. Steiner's view that staff should proceed with caution.

Mr. Daïri and Mr. Mohammed submitted the following statement:

The staff are to be commended on what has been a resource-intensive effort as indicated by the 880 FAD staff days devoted to the pilot, not including the contributions made by staff from other Fund departments, and by the staffs of the World Bank and the IDB. The effort will be worthwhile if some of the lessons help to refine Fund policy prescriptions for fiscal policy and remove unintended impediments to public investment in the context of Fund surveillance and Fund-supported programs.

The finding that the pilot cases reflect the general trend towards declining public investment that was noted in last year's papers may not be surprising but the studies fail to provide much insight into the connection between insufficiencies of public investment in infrastructure (as indicated by economic development bottlenecks) and growth prospects. We would suggest that further analytical and empirical work on this topic be remitted to the World Bank and other MDBs rather than for the Fund staff to engage scarce resources in exploring the channels through which infrastructure investment affects growth. Similar attention should be given to investment in human capital, whether classified as current or capital expenditure, which may have a stronger effect on growth than physical capital.

The conclusion that additional room for public infrastructure spending cannot be created by "methodological changes" for measuring fiscal outcomes or targets or by excluding certain investment or other expenditure from the fiscal balance will be disappointing to those who expected to find additional room to broaden public investment possibilities. Given the growing concern with debt sustainability levels, it is not surprising to find from Appendix Table 10 that in half of the eight cases, the high level of net public debt and the vulnerability of the debt dynamics to exogenous shocks left little or no space to relax fiscal targets. Of the two HIPC cases, which have both reached completion point, debt sustainability "remains precarious" for Ethiopia while in the case of Ghana, a "steady and brisk decline in the extended fiscal deficit" is said to be required "under anything but the most favorable financing scenarios." Peru has positive debt dynamics but its public debt remains high given the fact that it is mostly denominated in foreign currency. Only in the case of Chile, with a public debt ratio at 12 percent of GDP, is there said to be "no problem," although in an ironic twist, it is noted that increasing public investment "is not a matter of immediate priority for the authorities." It is important to recognize, however, that it is not appropriate to reach general conclusions on the basis of DSA considerations alone in a 8-country sample and we agree with the statement that a proper assessment of the scope for increasing public infrastructure spending in any particular country "requires a careful analysis of aggregate demand conditions, absorptive capacity, short-term financing constraints and medium-term public debt dynamics, as well as trade-offs with other types of expenditures in that country" and between taxes and public expenditure.

The limited scope for increasing public investment without a commensurate increase in public savings leads to the question whether there is a choice between revenue increases and expenditure prioritization. While this is clearly up to individual country authorities, we tend to agree with the staff view that, given the difficulties involved in obtaining substantial revenue increases in many countries, greater attention has to be paid to the expenditure side, and especially to the quality of public sector investment. The role being played by the World Bank in conducting expenditure reviews is commendable as are the care and attention in project appraisal and monitoring that are devoted by it and the other MDBs. However, there remains an important potential for raising revenue through tax policy and administration reform that needs to be tapped, and focusing on expenditure alone may not bring the necessary improvement in the fiscal position.

One issue that would have deserved further elaboration is the possibility of financing additional investment from the sale of state assets. While table 7 refers to this possibility, the paper does not elaborate further on the issue. Only in the summary of the pilot study on India is there an expression on the staff's view on the issue, namely that new investment funded from this source should earn at least similar return to preserve public sector net worth. Could this view be more explicitly incorporated into staff's conclusions in order to allow such investment to be offset by reclassification of privatization revenue above the line whenever such condition is met?

Turning next to the issue of the coverage of fiscal accounts, the earlier paper (SM/04/93) proposed to exclude commercially new public enterprises on the basis of a set of criteria. The current paper takes a more cautious view in light of the finding from the pilot studies that of the 115 PEs assessed, only three were judged to be commercially run according to the criteria tested in the pilot studies. The staff paper found, in particular, that a criterion like management independence is difficult to fulfill given public ownership and that governments may have "legitimate reasons" for regulating the pricing policies of PEs in monopoly positions or to constrain their wage increases as part of an incomes policy or for other social reasons. Indeed, it would not be appropriate to include PE s in the fiscal accounts, with the potential of unduly restricting their development, on the basis of their public ownership. The staff recommend to revisit the criteria in order to shift the focus from commercial orientation of public enterprises to assessing their fiscal risk potential. We consider the revised criteria enumerated in Box 3 to be quite elaborate; it may be difficult to agree on a set of criteria for inclusion, and the workload for staff monitoring may be overwhelming. We believe, for instance, that the existence of subsidies and transfers per se may not necessarily imply fiscal risks and should not be a basis for including a PE within the fiscal framework since these operations could well reflect the shareholders' contribution to financing new investment or compensate for quasi fiscal activities. While comprehensive data should be collected, as proposed by the 2001 Government Finance Statistics Manual on the operations of PEs and the nonfinancial public sector, there should be a preference to keep them separate from the general government. The decision to include or exclude all of the public enterprise sector in the aggregate fiscal accounts should be left to the authorities, and such decision would be easier to justify than the inclusion or exclusion of individual PEs since the required analytical work for making such a decision may be extremely heavy and may well fall beyond Fund mandate and expertise.

The next issue taken up in the staff paper is the role of public-private partnerships (PPPs) for promoting the private sector supply of infrastructure assets and provision of infrastructure-based services. Here the pilot studies largely confirm the conclusions reached in SM/04/93 while refining the institutional requirements, the use of public sector comparators, issues of risk transfer, government guarantees, and fiscal risk, etc. Here also, as in the case of the revised criteria for PEs, we are concerned that the staff recommendation goes too far in seeking "comprehensive disclosure of the known and potential future costs of all PPPs for the public finances and their incorporation in DSA" in order to forestall the risk "that some governments may be tempted to tailor PPPs to meet the requirements for their classification as private investment, by trading off higher project costs for increased risk transfer to the private sector." In our view, this approach would push the Fund into an area outside its core mandate and expertise. We reiterate our support for the development of an internationally agreed set of standards for PPPs evaluation and accounting that could inform policy development and surveillance.

Mr. Kashiwagi and Mr. Miyoshi submitted the following statement:

At the outset, we welcome today's discussion, and thank the staff for a well-written set of papers.

We welcome the staff's recognition that, in pilot countries, significant infrastructure bottlenecks exist, notably in the area of transportation, while public investment, which is supposed to address such bottlenecks, has declined. This decline has been at least partly attributed to a call for fiscal consolidation. Whether or not fiscal space exists for an increase in public investment depends on country-specific circumstances, including the country's stage of economic development and the authorities' administrative capacity. Accordingly, it is important for the Fund to pay sufficient attention to these circumstances in providing policy advice.

This chair believes that the impact of public investment on economic growth warrants further examination. The staff paper notes that empirical evidence remains to be seen showing that public investment, particularly infrastructure investment, has had a solid and positive impact on economic growth, and that such an estimate would be difficult to quantify due to data constraints. However, as paragraph 13 suggests, it is hard to deny that a country's poor road networks adversely affect its economic activity and export performance. It continues to be paramount to assess how and to what extent public investment, as one of governments' policy options, could contribute to achieving sustainable growth and poverty reduction in low-income countries.

In this connection, we note that underdevelopment of infrastructure is cited in many low-income countries, especially in Asia, as a serious bottleneck for growth. Recently, more Poverty Reduction Strategies have treated infrastructure investment as an important element of the authorities' development plans. Also, infrastructure bottlenecks, as well as policy and institutional environment, have been mentioned as one of the impediments to foreign direct investment (FDI), for example in the World Bank's recent Country Assistance Strategy for Cambodia.

One of the important challenges for low-income countries is how to reconcile the need to accommodate demand for public investment with the need to ensure fiscal soundness. The role of public investment is significant in low-income countries where infrastructure development is a priority but where the private sector lacks capacity. We hope that the Fund, in collaboration with the World Bank and other development institutions, will continue to give precedence to further analysis and study on this issue. In this connection, our authorities undertook a joint study with the World Bank and the Asian Development Bank on the policy framework for infrastructure investment. Drawing on a review of the relevant literature, the study concluded that there is a link between infrastructure development and growth or poverty reduction, and came up with some specific proposals on how to ensure that the benefit of growth derived from infrastructure development is fairly distributed among the people, and what role governments should play to achieve this objective.

In considering the impact of public investment on growth, the views of the private sector, especially those undertaking foreign direct investment, would also be critical. In this regard, citing the World Bank Investment Climate Survey, the staff notes that tax issues and policy uncertainty, rather than the availability of infrastructure services, are sources of concern for "private investors." We have learned, however, that "private investors" in the survey are domestic investors. From the viewpoint of what contributes to a country's economic growth, the inflow of foreign direct investment, which often accompanies knowledge transfer, should play a more important role. We suspect that good infrastructure services would be one of the important elements foreign direct investors take into account in their investment decisions. The staff's comments would be welcome on this point.

Additional room for public investment needs to be created not by changes in fiscal accounting, but by substantive measures. In this regard, we broadly concur with the staff's view that, in many cases an increase in public saving through a reduction in expenditure and/or an increase in revenue would be required to meet the need to ensure macroeconomic stability and debt sustainability. Country authorities should be primarily responsible for ensuring investment expenditure over the medium term, as many countries tend to curtail investment expenditure in the process of fiscal consolidation due to political difficulties associated with reduction or containment of current expenditure. Therefore, the authorities must first strengthen prioritization and ensure the quality of expenditure. In this regard, the staff appropriately stresses the need to continue to focus on the overall fiscal balance and its implication for macroeconomic stability and debt sustainability, while a complementary use of the current fiscal balance can help better gauge the quality of a country's fiscal policy. As the staff pointed out in paragraph 23, policy options for increasing public saving depend on country-specific circumstances. In addition, assessment of a certain country's debt sustainability could not be made without taking into account those circumstances. The assessment, therefore, should not be a mechanical application of a certain threshold level, but should allow plenty of room for judgment.

We agree with the staff's view that project evaluation and strengthening of implementation capacity are critical, given the difficulty in many countries to increase revenue on a sustained basis. We expect multilateral development banks to undertake rigorous project evaluations in extending their loans, as well as to provide technical assistance to their members to strengthen authorities' capacity in the above-mentioned areas. This is important also from the standpoint of maximizing the effect of infrastructure investment and ensuring fair distribution of its benefits.

We welcome the staff's flexible approach and their proposal for revised criteria on whether to include individual public enterprises (PEs) in fiscal indicators and targets, based on the results of pilot studies. The underlying thinking of the revised criteria, which places greater emphasis on the fiscal risks posed by individual PEs rather than on their commercial orientation, reflects the suggestion this chair made at the Board seminar in April 2004, which is welcome. That said, we note that a significant increase in resource costs by Fund staff would be necessary in order to make a judgment based on the revised criteria. While we can support the proposal to use the revised criteria on a trial basis in the upcoming Article IV consultation for a sample of countries selected by area departments, its impact on staff resources should be examined thoroughly and the cost and benefits of expanding the use of the revised criteria to all member countries should be analyzed carefully. A compilation of statistics on the operation of PEs based on the 2001 Government Finance Statistics Manual would be an ideal approach, though we should note that any progress made in this area is bound to be gradual, given the constraints expected in terms of both cost and capacity among individual members.

We broadly agree with the principles of the staff's proposal on the treatment of government guarantees envisioned mainly for Public-Private Partnerships, but the staff should also take due account of the associated cost and capacity constraints. The approach of setting too ambitious a deadline and urging all members to implement the staff proposals in a uniform manner would not be appropriate.

Based on our experience of public investment making significant contribution to economic growth in post-war Japan, we believe that we can provide numerous lessons to other countries in their developmental stage. For example, we see it as essential for the government to gauge and uniformly manage the financial circumstances of PEs and government guarantees. In order to do so, the authorities' capacity needs to be built up. Until that occurs, the Fund staff should continue to explain patiently to country authorities how the staff's proposals would be beneficial to fiscal management, and to provide technical assistance as necessary.

Mr. Solheim and Mr. Sidlauskas submitted the following statement:

We thank the staff for the set of well written papers following up on the Executive Board Seminar on Public Investment and Fiscal Policy in April 2004. The results of the pilot country studies underscore the importance of a case-by-case approach, and we support the suggested gradual approach for improved statistical coverage and transparency concerning public enterprises (PEs) and guarantees. Furthermore, we welcome the proposed shift in focus to the potential fiscal risks.

Staff has appropriately emphasized the significant resource implications of their recommendations. The suggested approach to use a sample of upcoming Article IV consultations, to allow for a better design of a strategy within this area consistent with resource limitations, appears to be pragmatic and reasonable. We would like to emphasize the need for close collaboration with both statistical agencies and other IFIs, including in carrying out an ambitious research agenda. We support the publication of these highly readable papers on topical fiscal subjects in many of our member countries.

Findings of the new pilot studies do not fundamentally change the views of this chair during the Board seminar in 2004. Capital expenditures should not be given preferential status neither in the budgetary policy of countries nor in the fiscal indicators and targets used by the Fund. Coverage of public enterprises, public private partnerships (PPPs), and government guarantees in the fiscal accounts should be determined by the actual and potential fiscal risk of these entities and instruments.

High-quality public investments, including in infrastructure, are essential for growth, particularly in low-income countries where the private sector may be weak. Unfortunately, politically motivated and misguided public projects have been widespread in many countries leading to a waste of resources. Further analytical and empirical work is needed on the relationship between public investments and growth. The Fund's focus should remain on issues of importance for macroeconomic and financial stability, whereas the World Bank and other organizations would seem better placed and equipped to shed further light on the channels through which public investments, including infrastructure outlays, affect economic growth and in advising countries on the best sequencing in implementing competing projects. Moreover, the Fund should be well placed to contribute to the development of operational statistical standards and guidelines in this area.

Staff has underscored the importance of strong budgetary procedures and institutional frameworks in dealing with the various trade-offs involved in fiscal policy planning. Also in this area, Multilateral Development Banks would seem to be best positioned to take the lead in helping countries enhance their capacity. We agree with staff that concerns about macroeconomic stability and debt sustainability often necessitates increased public savings to create room for additional investments. We would caution against generally putting lesser emphasis on achieving sustainable increases in revenue, but staff is right in stressing the need for expenditure prioritization. The finding of the surveys underscores the importance of a balanced and sound fiscal policy to make space for the needed public investments rather than increase investments by borrowing.

The investment climate surveys in the pilot countries reinforce the point that investment in public infrastructure services is not high on the list of private investor concerns. While the Fund's sample is limited, the results are consistent with the World Bank study based on a much larger country group. Furthermore, the results are consistent with the prevailing view that strong and sustainable growth requires strong institutions, good governance, and a business-friendly environment. Without this supportive climate, accumulation of physical capital can do little to promote sustainable growth.

We support a transparent coverage of PEs within the GFSM 2001 framework. We also support a shift of focus to the fiscal risk potential of PEs in the coverage of PEs in fiscal indicators and targets. We appreciate staff's readiness to gradually explore this area within the available resource envelope.

The private sector should be allowed and encouraged to take part in infrastructure projects, especially in sectors with a clear commercial potential. However, countries should make sure that the private sector takes on its part in bearing the risks and obligations, thus shielding the fiscal position from the failures of private investors. In this regard, we welcome staff's recommendations on increasing transparency and limiting fiscal risks related to the activities of PPPs. We want to reiterate that strong public institutions, a well-established regulatory framework, and full transparency should form the base for PPP operations. As in the case of PEs, IFI's could play their role in disseminating best practices for the regulation of PPPs.

Turning to guarantees, we find it important to have quantified the potential costs arising from guarantees under PPPs. Public guarantees and commitments under PPP contracts should be reflected in debt sustainability analysis. We also see merit in staff's suggestion to set caps on the size of the PPP program in appropriate circumstances. Like Mr. Padoan and Mr. Gola, we find it important that implicit guarantees are made explicit when possible, or at least to have adequate provisions set aside for such contingent liabilities.

Ms. Jacklin and Ms. Segal submitted the following statement:

Key Points

▪ Additional room for public infrastructure spending cannot be "created" by changes in fiscal accounting. A proper assessment of the scope for increasing investment spending requires a careful analysis of a country's macroeconomic condition and the quality of proposed projects, which cannot be detached from the overall budget. Increased spending on public investment must be considered in the context of limited public resources, particularly in countries with sensitive debt dynamics.

▪ Developing international "best practices" related to project selection and structuring as well as budgeting and accounting would help maximize benefits of investment spending and promote fiscal transparency and macroeconomic stability.

▪ With regard to investment spending, there should be a clear delineation of IFI roles, with the Fund taking the lead on best practices in fiscal accounting and the MDBs pursing best practices in the areas of project selection, structuring and monitoring.

▪ Infrastructure projects should benefit from a better selection process based on standardized cost/benefit analysis and feasibility studies. The MDBs are best placed to assist countries in obtaining the technical support they need.

▪ The Fund should move in the direction of standardizing treatment of PEs across regions. We are not prepared to support fully the "flexible approach" proposed by the Fund based on degree of fiscal risk posed by PEs.

▪ PPPs properly constructed offer a useful way to blend public and private resources to economize on scarce public resources. PPPs should be undertaken when projects are shown to be most efficiently carried out through a combination of private and public participation. Establishing an international accounting and reporting standard should be the goal of standard-setting bodies' ongoing work in this area.

We thank the staff for a comprehensive set of papers and for their considerable work on the issue of public investment and fiscal policy. We would also like to acknowledge the participation of the eight pilot countries; their experiences have been essential to furthering this discussion to the benefit of the IMF and its membership. The staff reports cover a wide range of issues and underscore essential principles that guide sound fiscal policy and serve in the interest of macroeconomic stability.

Fiscal Accounting and Prioritizing Public Investment Expenditure

An essential finding of the Fund's work concludes that additional room for public infrastructure spending cannot be "created" by changes in fiscal accounting. As the paper highlights, a proper assessment of the scope for increasing investment spending requires a careful analysis of aggregate demand conditions, the quality of the proposed projects, short-term financing constraints and public debt dynamics which cannot be detached from a country's overall budget, which includes both current and capital expenditures. Transparency further argues for a consolidated budget to avoid classification of expenditure to serve short-term needs.

In addition, increased spending on public investment must be considered in the context of limited public resources, particularly in countries with sensitive debt dynamics. Given the scarcity of public resources and the importance of investment expenditure, maximizing effectiveness of public spending while maintaining sound fiscal reporting practices is critical. We agree with the staff's discussion of ways to increase investment in the Lessons from Pilot Countries paper paragraphs 17–24 and in particular the focus on prioritizing public spending to create fiscal space. Countries must set priorities and accommodate these priorities within the appropriate spending envelope. That envelope will be a function of a country's debt level and specific vulnerability to shocks.

We believe the current division of labor between the IMF and the MDBs—with the IMF focusing on macroeconomic issues, in this case fiscal treatment of public investment financing, and the MDBs focusing on microeconomic foundations of development—remains appropriate. We also believe continued research on public and private investment including development of a comprehensive set of international "best practices" should be taken up actively by the MDBs. Such "best practices" should cover the gamut of observations made in the staff report: legal framework for PPPs and concessions, regulatory frameworks, project selection and feasibility studies, consultation with stakeholders, contract specification and oversight, financing structures, bidding and tendering procedures, dispute resolution mechanisms, clear monitoring roles, and ex post evaluations. The Fund should contribute to these best practices in the areas of transparent budgeting and accounting.

Improving Institutions for Investment Planning and Project Evaluation

The Pilot Countries Studies find significant scope to improve the efficiency and quality of infrastructure expenditure through better public investment planning and project evaluation. This finding is consistent with anecdotal evidence of poor project selection and/or inefficient and sometimes incomplete project execution in countries with poor infrastructure stocks. A key outcome of the Fund's work is the recommendation to focus efforts on strengthening institutional capacity for project evaluation, selection and execution and the finding that better institutions generally coincide with higher private investment. This is particularly true for countries facing limited fiscal resources to address public investment needs, where a suboptimal project or inefficient execution of worthwhile projects can have grave fiscal consequences. For public investment projects, countries should seek capacity-building technical assistance to better prepare line ministries to conduct their own feasibility studies and prioritize infrastructure projects based on standardized cost/benefit analysis.

We are very interested in Brazil's recently announced public investment pilot, which seeks a comprehensive approach to the issue of public investment management, starting with conditioning access to public resources on strengthened project appraisal, selection and monitoring and implementation of public projects. While Brazil's program seeks to ensure adequate resources for execution of the program with a slight downward revision of the primary surplus target, the program entails no methodological changes to exclude investments from the primary balance nor other changes to the calculation of fiscal targets. In addition to Brazil's efforts, among pilot countries, Chile stands out as a leader in integrating cost-benefit analysis into the project selection process, as well as ongoing performance monitoring and evaluation. We would encourage the pursuit of similar programs for other countries that may be interested. Importantly, such analytical capacity should also cover an assessment of financing options, including if projects would be good candidates for Public Private Partnerships (PPPs). In this area, it seems the MDBs and bilateral donors are best equipped to provide technical assistance to interested countries. Such assistance should be focused on enhancing countries' capacity for project selection and execution, including training in standardized methodologies for rigorous project review, as well as financial and risk analyses, as part of the country strategy for achieving sustainable growth and reducing poverty.

Coverage of Fiscal Indicators and Targets: Treatment of Public Enterprises

We appreciate the staff's extensive work to assess the coverage of Public Enterprises (PEs) in fiscal accounts. In general, it is clear that the Fund should move in the direction of standardizing treatment of PEs across regions. The staff's recommendation for member countries to begin to systematically compile and disseminate statistics on the operations of their PEs seems appropriate. Given the staff's experience in evaluating PE operations in the pilot countries, we would appreciate their rough estimate of what would be a reasonable time frame to allow for countries to comply with this reporting requirement.

With regard to the coverage of PEs in fiscal indicators and targets, again we believe that in the long run a standardized approach will be most transparent and effectively guarantee equal treatment of countries across regions. In practice, this will be difficult to achieve, given that currently different standards have led to different expectations of the "right treatment" of PEs in fiscal indicators and targets. However, we are not prepared to support fully the "flexible approach" proposed by the Fund based on degree of fiscal risk posed by PEs. First, we believe this has the potential to result in differentiated treatment of Fund members. Second, we note the staff's comment that this approach may involve "significant resource costs in both surveillance and program design" without a clear understanding of the obtainable benefits. Third, the approach would inevitably involve the Fund in assessing individual PE operations, an area where the Fund lacks expertise or a comparative advantage in developing it. At this stage of our learning we would support a few additional pilot cases focused on this issue in order to determine the best path to arriving at a standardized approach and the gradual migration in countries' fiscal accounts to a standardized treatment of PEs.

Public Private Partnerships and Government Guarantees

As highlighted in the staff report, Public Private Partnerships (PPPs), if properly structured, offer countries a useful way to blend public and private resources to economize scarce public resources, but PPPs should be undertaken for the right reasons. Governments should turn to PPPs based on an informed analysis of each project including careful consideration of all risks, not simply in an effort to move investment spending off-budget and debt off-balance sheet. Maximizing the benefits of a PPP program requires sound foundations as outlined in the staff report, including clear supporting legislation. Such clarity must extend to accounting treatment for PPPs, but there is still no internationally agreed fiscal accounting and reporting standard. Establishing such a standard is a first-best outcome, and should be the ultimate goal of the Fund's—and relevant international accounting and statistical standard-setting bodies' such as EUROSTAT—ongoing work in this area.

Acknowledging that this first-best outcome will take some time, and in light of the very real near-term risks of improper use of PPPs to bypass spending controls and moving public investment off-budget and public debt off-balance sheet, we agree with the staff's recommendation requiring disclosure of PPPs as an annex to budget documents and year-end financial reports and/or in the form of a "Statement on PPPs" (perhaps assigning a minimum threshold for the disclosure requirement) and evaluation of their potential impacts on country DSAs. The latter could incorporate future payments under PPP contracts, including expected payments from called guarantees, in the context of DSA sensitivity analysis. In keeping with our comments on Investment Planning and Evaluation, we also agree with the staff's recommendation that a public sector comparator should be included as part of any decision to undertake a PPP in order to guard against use of PPPs simply to avoid budgetary and balance sheet consequences of a given project. Establishing a cap on the overall size of a country's PPP program in the context of Fund program should be determined on a case-by-case basis, depending on the financial condition of the country.

Mr. Raczko and Mr. Piatkowski submitted the following statement:

Key Points

▪ Public investment is rightly seen as only one of the growth factors.

▪ Highest returns on public investment are achieved when it is supported by a conducive institutional environment and a sound fiscal position. In addition, depending of the level of institutional and economic development, returns on public investment are likely to be non-linear.

▪ Incorporating PPPs and government guarantees in a DSA improves Fund's surveillance.

▪ Comprehensive coverage of PEs in national statistics increase financial transparency.

We welcome this discussion on public investment. The analysis initiated last year aimed at finding ways to make more room for public spending by adapting new approaches to fiscal accounting. The underlying idea was to boost the private sector's role in providing infrastructure to foster growth. Pilot projects undertaken in this connection provide highly relevant findings: the institutional framework and the fiscal sustainability are key elements of public investment's growth. These findings call for a more active role of the Fund in capacity building and fiscal accounts.

The pilot projects' studies pointed out that public investment is just one of many ingredients of growth. Factors like the tax policy, regulatory framework, macroeconomic stability, property rights, good governance etc. are at least equally important. While the evidence for the linkage between public investment and growth is mixed, public investment in our view can contribute to growth if it is supported by a conducive institutional environment and a sound fiscal position. In fact, it may as well be that returns on public investment are non-linear depending on the level of institutional and economic development: first, returns on public investment in countries with an underdeveloped institutional framework can be low or even negative; later, however, at a higher level of development, returns are likely to become significantly positive (as, in our view, is the case of the new EU member states); finally, for developed countries, returns are likely to be low again as new public investment yields diminishing returns. This view needs to be, however, supported by empirical evidence. We thus encourage staff to continue their work, in cooperation with the World Bank, on determinants of productive public investment, especially with regard to the fiscal position and macroeconomic stability, which lie at the core of the Fund's mandate.

The pilot projects confirmed our view that a strong institutional framework increases the effectiveness of public investment. Yet, a well-developed institutional framework is also a prerequisite for an increased private sector involvement in the provision of infrastructure. The effectiveness of infrastructure spending will also be improved if the authorities ensure that ongoing projects are completed and their maintenance costs are monitored. When new investments are projected, it is necessary to also ensure that the project appraisal and implementation capacity are sufficiently strong. This is particularly important for countries where a weak institutional framework and a lack of transparency could lead to resource misallocation.

The pilot projects also made it clear that increasing public investment in infrastructure hinges on the fiscal stance of the government. We agree with the view that fiscal consolidation is likely to have contributed to observed declines in public investment. It is a well-known fact that governments prefer to cut investment spending rather than social transfers. In our opinion, sound public investment decisions require the adoption of a mid-term budgeting based on the expenditure evaluation. The increase of public investment should then be financed mostly by spending reprioritization or increases in domestic revenues without jeopardizing fiscal discipline, which is needed to ensure debt sustainability. For this reason, the authorities should step up their fiscal reforms if they want to increase public spending in infrastructure. The sustainability of the fiscal position is one of the keys to future growth.

We support staff's approach towards disclosure and reporting requirements of the cost of all PPPs for the public finance and their incorporation in the DSA. While the establishment of PPPs is commonly associated with an increased efficiency in providing public investment in infrastructure, the pilot projects rightly highlight the importance of having in place adequate institutional requirements of monitoring risk transfer and incorporating the PPPs in the DSA.

Since the expected value of guarantees is part of the governments' contingent liabilities and thus carries a potential fiscal cost, we support staff's recommendation of including it within the DSA. We also support staff's recommendation of having a centralized control over the granting of guarantees to facilitate the integration of the information as a requirement for transparency and accountability. Equally important, the implementation of control mechanisms should be, where relevant, included in the program conditionality to reduce moral hazard and discourage an indiscriminate use of the instrument.

Government balance sheets should treat guarantees in a similar manner as the private sector does. The valuation of contingent liabilities resulting from guarantees should be used to better quantify the potential cost arising from guarantees. In this light, greater emphasis on institution and capacity building inside the government should be a key element in the Fund's strategy not only for dealing with government guarantees but also with the coverage of PEs.

Inadequate coverage of PEs in fiscal accounts poses fiscal risks, weakens Fund's surveillance and program effectiveness and makes international comparability difficult. Therefore, we support staff's call for a comprehensive coverage of PEs in national statistics, preferably within the GFSM 2001 framework, to enhance monitoring and reporting of fiscal risk. The Fund should encourage separate reporting of components of consolidated public sector accounts as it can increase transparency, help trace problems at their source and accordingly take adequate measures. Nevertheless, while accomplishing this task, a balance should be struck between staff resources and the benefits of this coverage by focusing on the most relevant potential risks.

Mr. Lynch and Mr. Kruger submitted the following statement:

Key Points

▪ We welcome the lessons of the pilot projects, in particular, the evidence that weak institutions and a poor business climate are, in general, more important constraints on private investment than the quality of infrastructure.

▪ The overall fiscal framework poses a binding constraint. There is no substitute for hard prioritization and ensuring that the marginal return of each expenditure exceeds the cost of finance.

▪ We support further research on the sources of growth and the impact both private and public investment can make.

▪ While debt sustainability concerns will deny many countries additional fiscal space for public investment, the case of India appears to indicate that prioritization can still lead to impressive results.

▪ We support the use of broad fiscal indicators that indicate the maximum fiscal risk posed by public enterprises and which do not involve making difficult judgments on an enterprise-by-enterprise basis.

▪ We support accounting for the known and potential risks of Public-Private Partnerships (PPPs) in debt sustainability analyses. However, we are unconvinced of the need for an additional cap on PPPs.

We would like to thank the staff for an interesting and comprehensive set of papers and for what appears to be a sizeable effort on the pilot projects. The lessons from the pilot projects are welcome. In particular, we would note that infrastructure bottlenecks, in general, do not constrain private investment as much as weaknesses in institutions and the business climate.

Public Accounts and Accountability

In discussing the treatment of public investment, it is imperative that we remember that expenditures, revenues, and borrowings have to be consistent with an overall fiscal framework. We would reiterate the staff's comment that additional room for infrastructure spending cannot be created by changes in fiscal accounting. While it might appear that some tax cuts will be self-financing or that some expenditures will pay for themselves, there really is no substitute for hard prioritization and ensuing that the marginal return of each expenditure exceeds the cost of finance.

Public Investment and Growth

We believe that the Fund should be actively engaged in researching the sources of growth, with an emphasis on raising productivity and potential output. This research should draw on work done elsewhere and could be in collaboration with others. In order to be useful, country experiences need to be measured consistently and organized under a common paradigm.

Clearly, both private and public investment have roles to play in this process. However, it is not surprising that the staff's "simple statistical exercises" did not find an unambiguous positive correlation between public investment and growth. Growth is a complex phenomenon, which can be affected by a large variety of factors. Moreover, data problems might arise from the way in which government expenditures are classified and whether accounting is done on a cash or an accrual basis.

Public Investment and Macroeconomic Sustainability

For countries that are operating close to their limits of debt sustainability, even high-quality investment projects funded through additional borrowing could increase macroeconomic vulnerability, imperiling growth and development. These countries should find fiscal space through additional saving or better prioritization.

The case of India indicates that improved outcomes can be associated with lower levels of public investment. The staff notes that public investment fell sharply in India in the 1990s. Nevertheless, Table 1 shows that India's indicators improved markedly in each of the four infrastructure categories. The staff's comments on how this came about would be helpful.

The lack of additional fiscal space, which confronts many countries, argues strongly for rigorous project appraisal and expenditure prioritization. The MDBs clearly have a role here. However, we were struck by the high rate of return, noted in footnote 13, associated with World Bank financed projects. Does this reflect sample selection bias?

The staff notes that political economy factors can influence project selection—for example, by politicians favoring new projects over completing ongoing ones. Indeed, we would suggest that political considerations can also lead to the costly error of failing to maintain existing infrastructure in favour of beginning new projects. We would be interested in hearing more about how the Chilean model counters these tendencies and how the new Brazilian pilot program takes steps to mitigate these risks.

The Coverage of Fiscal Indicators

As a general principle, we believe that the fiscal indicator should account for those activities that represent a liability for the taxpayer. Thus, we agree with Mr. Steiner that the broad coverage of the public sector in Latin America should become the norm for all countries and regions, since this would account for the maximum fiscal risk (and fiscal benefit) due to public enterprises. In countries that suffer from data and capacity constraints and report on a narrow basis, we support the ongoing inclusion of public enterprises—at least the largest ones—in a consolidated measure.

We do not feel that the inclusion of public enterprises in a consolidated measure of the fiscal position would unduly hinder their ability to borrow. The consolidated measure should account equally for an enterprise's debt servicing capacity as well as its debt. Indeed, the inclusion of strong public enterprises would improve the picture presented by a narrow fiscal measure.

Like Ms. Jacklin and Ms. Segal, we are skeptical of the staff's proposal to include or exclude public enterprises based on their assessment of their fiscal risks. We would prefer the application of the principle of "resource to the public purse" to a system of complex judgments. The staff notes that its recommendations will require significant additional staff input. Moreover, it appears that the revised criteria set out in Box 3 will still leave the staff in the unenviable position of making difficult judgments. Finally, the staff notes that application of the revised criteria might result in the exclusion of public enterprises from the comprehensive fiscal measures used in most Latin American countries. This would be a retrograde step.

Disclosure and Reporting Requirements for PPPs

PPPs offer governments benefits arising from both efficiency from private sector participation and the ability to tap into a broader pool of capital, some of which could be flight capital.

However, like the staff, we are concerned that some countries might try to tailor PPPs by trading off high project costs against increased risk transfer to the private sector in order to have these projects count as private investment. This underscores the importance, as noted above, of rigorous project selection criteria.

We believe it is imperative that when a PPP implies recourse to the taxpayer, these costs should be calculated and put on the government's books. We agree it is important that the known and potential costs of PPPs be fully disclosed. Accounting for the known costs as future expenditure in the debt sustainability analysis is appropriate. Accounting for contingent liabilities through stress testing appears to be reasonable treatment.

We are unsure of the merits of a specific cap on PPPs. In our view, it is the aggregate future liability given by the debt sustainability analysis that is important. A country may want to trade off the liabilities associated with PPPs against those arising from other types of debt, while keeping within this ceiling. Such a trade-off could be appropriate.

Mr. Duquesne submitted the following statement:

We thank the staff for its clear and well-documented set of reports dealing with such an important topic. We agree with most of its recommendations and proposals for the way forward, some of them being far-reaching for the Fund's surveillance. We welcome these papers being published.

There is a need for refined empirical studies on the links between public investment and economic growth, in particular on the identification of the transmission channels. The World Bank (see, for instance, the June 2004 report Reforming infrastructure: privatization, regulation and competition) has developed various and interesting analyses, notably on the reasons why hopes raised by the substitution of public investment by private investment (or sometimes PPPs) have fallen short of expectations; the decline in public investment is reinforced by declining private financing. Several areas deserve more particular scrutiny: comparing the effects of maintenance and rehabilitation investments relative to new investments; testing the hypothesis that public investment in infrastructures has a positive impact on growth only beyond a certain threshold; assessing the needs according to a country's development stage. Further explanations of the links between public expenditures and growth are fundamental insofar as, conversely, the fiscal stance depends on future growth assumptions.

Generally, we share Messrs. Misra and Gauba's view that there is a tendency in this report to downplay the importance of public investment infrastructure for growth. In fact, this importance is hardly disputable, in particular when the lack of infrastructure creates bottlenecks. It is needless to recall the abundant literature on endogeneous growth, in particular Barro's work on the subject. One can also observe that the reduction in public expenditures in infrastructure usually evolves in parallel with the reduction in the fiscal deficit. Here, like Messrs. Misra and Gauba, we regret that the report does not touch upon the issue of the possible correlation between the decline in public investment and Fund programs.

Long-term debt sustainability must remain the pivotal criterion to evaluate the room needed for additional public investment. However, the judgement here is not straightforward: the impact on debt is relatively easy to assess (in the absence of an exchange rate risk), whereas the impact on growth is more difficult to estimate. It is therefore necessary to develop some analytical tools in order to better quantify the impact of an investment on growth; the quality of the investment should be the secondary criterion after debt sustainability. Whenever possible, it would also be useful to complement the debt sustainability analysis by a public asset / liabilities balance sheet approach. In this regard, could the staff elaborate a little further on their (rather negative) assessment of the option put forward by the Indian authorities to use some of their foreign exchange reserves to finance infrastructures?

Expenditure prioritization should obviously be emphasized as a means to increase the efficiency of public expenditures and to better calibrate their composition. The role of the MDBs (and of bilateral donors) is to provide a technical assessment on the anticipated rates of return, on the optimal financial scheme, and on the country's capacities to implement and monitor the investment in the long run, so as to help the authorities to set their priorities The latter, obviously, must remain the authorities' own decision. Another important parameter in evaluating investment efficiency lies in the political or administrative structure; the comparative studies between India and Brazil seem to indicate that the Fiscal Responsibility Law in Brazil had a positive impact on public savings and has created more room for maneuver for public investment.

Considering the findings of the pilot studies, we concur with the staff that the criteria defined last year for considering the exclusion of commercially run public enterprises from the fiscal indicators and targets, are not fully relevant to assess the fiscal risks entailed. The revised criteria seem more appropriate, and we concur with the staff's approach to test those in the Article IV consultations of a diversified and representative sample of countries across all area departments. Any refinement based on this first experience should be pragmatic. In the same vein, a case-by-case approach to consolidation, or to a separate treatment, of the public enterprises' operations with the general government should be applied in specifying fiscal indicators and targets, depending on the potential fiscal risks.

All the same, we support staff's view that assessments should integrate known or potential costs—including guarantees—reflected in the PPP contracts, according to agreed international fiscal and accounting standards. Ideally, these costs should be taken into account in DSAs, but the methodology would require further cautious discussions. We also emphasize the exchange rate risks involved in the private partners' investments in foreign currency whereas revenues are in local currency. Building on the pilot study for Peru, we would like to have staff's opinion on the type of financial scheme recently put in place in this country, where the World Bank provides a partial guarantee to the private sector, notably on the legal environment, and where the governement ought to repay the disbursed part of the loan to the Bank in case the guarantee is activated.

We concur with the staff on the desirability to build a centralized and transparent framework for governments' contingent liabilities.

As a conclusion, a key objective is to better harmonize the Fund's and the World Bank's perspectives on these issues. We would appreciate it if the Bank staff would attend this meeting and give its appreciation of these reports, before the Briefing scheduled at the Bank on Tuesday. Both institutions must closely collaborate on the provision of advice and technical assistance. Regarding the Fund, we thank the staff for addressing in their report the resource implications of their own recommendations; we concur with Messrs. Padoan and Gola that the issues of composition as well as the quality and the efficiency of public expenditures should be primarily handled by developments banks.

Mr. Ondo Mañe submitted the following statement:

We thank staff for an informative set of papers and we are appreciative of the pilot studies that have been conducted in support of the study. The lessons that the staff has drawn from the pilot country studies are very useful. Yet, we sense that these lessons could have certainly been made even more valuable by the participation of industrial countries in the pilot. Given the rich experience of these countries in addressing public investment needs while preserving fiscal sustainability, staff analysis could have been better evidenced had some of these countries been included in the sample of pilot countries. Moreover, we think that the paper would have been more useful if it had looked at how public investment can be accommodated in fiscal policy in countries at different stages of economic development. Depending on whether countries are low, middle or high income, the approach may be different and the instruments could also be different.

The staff's conclusion that no explicit relation between public investment and growth was detected in the pilot countries owing to data limitations and staff resource constraints does not imply that this relation is nonexistent. There are plenty of evidence of the role played by the construction of infrastructure such as roads, and railways in the development of many regions and countries. For our part, we remain convinced that the lack of adequate infrastructure continues to impede many developing countries' growth potential. Indeed, as staff rightly emphasized in their previous analysis, infrastructure gaps may undermine the affected countries' growth potential, as was shown in the case of Latin America (SM/04/93). Therefore, this inconclusive finding points to a need for the IMF along with the MDBs to invest more resources to research activities that aim to unveil the nature of the relation between growth and public investment.

In many low-income countries, public investment continues to be severely constrained because of limited public savings and the heavy debt burden. Under these circumstances, increasing private investment may be the unique way of increasing total investment. In this regard, we share the staff's presumption that proper incentives could make the private sector eager to participate further in the provision of infrastructure services. We are of the view that the private sector has a critical role to play in the economic development of developing countries. When governments are not able financially to make the necessary capital spending, it is important that they create an enabling environment that is conducive to the development of the private sector, which can then contribute to improve infrastructure, and thus enhance the competitiveness of the national economy. As in our past statement on this topic, we reaffirm the importance of promoting PPPs and we would like to reiterate that technical assistance is paramount to developing the authorities' technical expertise and capacity in the design and monitoring of PPPs. It is also important to work on strengthening the institutional underpinnings on which PPP programs are to be based. In this connection, our authorities are already undertaking the reforms needed to improve the business climate so as to promote private investment. It is important that development partners give adequate support to initiatives that are underway in many low income countries to promote PPPs in infrastructure development. In particular, NEPAD's efforts to encourage and assist African countries in the creation of PPPs in infrastructure development are worth noted.

However, it has to be kept in mind that private sector investment cannot fully substitute for additional public investment. The staff reports appear to be inconclusive on this issue. Although Figure 1 in SM/05/118 depicts a negative contemporaneous correlation between public and private investment in the pilot countries during the 1994-2003 period, one can expect these two fundamentals to be uncorrelated in reality. Indeed, the intrinsic characteristics of public goods, non-rivalry and non-excludability, make it difficult to ensure the profitability of their exploitation by private operators regardless of the incentives provided. Therefore, it is crucial that fiscal space be systematically freed in the design of Fund-supported programs to allow public investment in social infrastructure even in the presence of strong PPPs.

Ideally, higher public saving is one of the most suitable methods of financing for additional public investment given that it preserves macroeconomic stability and debt sustainability. However, low fiscal revenues and pressing social needs continue to prevent any increase in public saving in low-income countries.

Under these conditions and in the context of fiscal adjustment, emphasis on expenditure prioritization is necessary, but not sufficient to create enough room for additional public investment. We concur that the productivity of public investment should be increased particularly through the strengthening of implementation capacity and project appraisal. We would also suggest that more focus be put on fiscal adjustment on the revenue side, that is, through increased revenue mobilization. Such a move could be prone to create higher public saving without downsizing priority social spending, which can jeopardize the achievement of growth and poverty objectives.

With regard to project evaluation and implementation, we support the staff's call for the international financial institutions to help strengthen countries' capacity through technical assistance and training. We also note that some IFIs including the Fund have started to deliver a series of seminars on public investment planning, budgeting, and implementation, and on fiscal issues relating to PPPs. We view this initiative as a right step towards strengthening the countries' capacities in these areas. Since we believe that these seminars are of great value, we would appreciate the staff's comments on when African officials can be expected to benefit from such seminars.

As far as fiscal sustainability assessment is concerned, the assessment of the fiscal risk potential of public enterprises seems to be more relevant than the assessment of their commercial orientation. In this vein, we are attractive to the staff's proposal to shift the focus from the latter to the former. The revised criteria for assessing the fiscal risks of public enterprises seem broadly adequate. However, in further refinements of these criteria, it would be useful to make them capture more adequately potential sources of fiscal risks that are associated with the imports/exports activities of public enterprises.

In defining fiscal indicators and targets, we concur with the staff that flexibility is needed as to whether the operations of covered public enterprises should be consolidated with the general government. We agree with the staff's suggestion that "[...] the decision on whether fiscal reporting and monitoring, and fiscal indicators and targets, should focus on the consolidated public sector, or the general government and public enterprises separately, is one that should be taken on a country-by-country basis," (SM/05/118, p.33). Still, we strongly caution against putting the focus on the consolidated public sector in the case of low-income countries where public investment is severely constrained. While we agree that the sound financial position of public enterprises should be maintained in any case, we are concerned that the coverage of these enterprises by fiscal targets and conditionality would restrain unduly their investment and affect adversely their competitiveness.

As fiscal adjustment leaves little room for public infrastructure investment, we would like to call on the MDBs and IFIs, including the IMF, to provide complementary sources of financing to program countries, particularly

LICs, in support of their efforts to build social and basic infrastructure. Without additional financing that would constitute an alternative to low, and oftentimes-negative public saving, it is highly unlikely that the objective of sustainable growth usually sought by IFIs-supported programs will be achieved. In this regard, we welcome recent debt relief proposals formulated with the aim of promoting basic infrastructures needed for sustainable growth and look forward to their implementation. We think that it is also necessary to put in place other concessional financing facilities that developing countries can tap to build the needed infrastructure. In this way, fiscal consolidation or debt sustainability can be achieved without undermining capital investment.

In the pilot studies, while we welcome the choice of Ghana and Ethiopia, we think that the paper should also have looked at the situation in the CFAF zone countries. This is a regional grouping of countries that has special characteristics. Unlike many other developing countries, they have a fully convertible currency, and fiscal policy is the most important policy instrument. Yet these countries have found it very difficult to make the public investment needed to develop their economies. It would be useful in a future pilot study to look carefully at these countries, and the fact that they enjoy a certain amount of regional and economic integration, and to see how to accommodate increased public investment in infrastructure in fiscal targets, while ensuring macroeconomic stability.

Mr. Scholar and Mr. Gregory submitted the following statement:

We are grateful to staff for an excellent set of papers, which provide a thorough analysis of the results of the eight pilot country studies, and comprehensively address many of the issues raised in the previous Board discussion of public investment and fiscal policy. We support all of the main conclusions of the paper, particularly the findings that: policy options for significantly increasing public expenditure are limited, especially in countries with relatively high levels of public debt; that additional room for public infrastructure spending cannot be created by changes in fiscal accounting; that there is a clear need to improve the quality and efficiency of public investment; that there is a similar need to strengthen the policy and institutional frameworks affecting private investment; and that PPP's are a good alternative to public investment, but that they need to be driven by efficiency needs rather than budgetary concerns.

Public Investment and Economic Growth

The paper presents a very useful analysis of the role of public investment in promoting economic growth, which reflects the considerable difficulties in identifying a direct relationship. We note that there is an increased consensus that public capital furthers economic growth, but questions clearly remain as to the magnitude. We would also emphasize the point made that there is more robust evidence for developing countries of a positive impact of public investment on growth. We support the staff's ongoing work in this area, which was also highlighted in the recent papers on program design (SM/04/405).

The paper notes that it is not clear whether infrastructure investments would have higher returns than current spending, and that these will therefore have to go hand in hand. We fully support this conclusion, which is reflected in the recent report of the Commission for Africa, which emphasizes that "*a loss of focus on the importance of growth for poverty reduction, and a failure to appreciate the important complementarities between investment in infrastructure and the social sectors have contributed to the fall in spending in infrastructure and a lack of emphasis on it in many national poverty reduction strategies.*"[9]

Coverage of Fiscal Indicators and Targets

We support the staff's suggestions on the way forward to improve the coverage of fiscal indicators and targets. The proposal for staff to engage in discussions with the authorities on compiling aggregated statistics as a part of future Article IV consultations is a sensible approach, and should be done in a selective way as part of the overall surveillance toolkit. This can be done with no additional cost to the Fund's surveillance activities, and could, for example, be covered through a number of individual Article IV selected issues papers. As the paper highlights, the Fund will need to take into account country circumstances so the approach should be both gradual and flexible.

Role of Public Private Partnerships

We agree with many of the conclusions drawn in the paper on the subject of PPPs. The central aim of PPP projects in all countries should be to improve the efficiency and value for money of investments, and PPP projects should not be adopted as a mechanism for governments to realize short-term advantages in the presentation of their fiscal accounts. We agree that social infrastructure raises different issues for PPPs than economic infrastructure, for example in the choice of the public sector comparator, and agree with the staff comments, which are consistent with the possibility of successful social infrastructure PPPs, in carefully defined circumstances (as has been the experience of the UK). But we also recognize that success has not been even across all PPP projects,[10] and commitment to PPPs therefore needs to be open, evidence-based and dedicated to continual improvement in the policy.

[9] "Our Common Interest." Report of the Commission for Africa, March 2005.

[10] There are examples of areas that are not suited to the PPP model. IT is certainly seen as one, because of the pace of change in the sector and the close integration of IT with other business systems.

Finally we support the staff's comments on the accounting treatment of PPPs. We also concur with them that future payments by the government under PPP contracts, and expected future payments arising from called guarantees, be counted as future primary spending in calculating the primary balance path required for debt sustainability.

Mr. Ngumbullu and Mr. Ukpong submitted the following statement:

Introduction

We thank staff for their insightful and well-written set of papers. From the outset, we would like to note that as the observations by staff regarding infrastructure spending, public investment and growth are tentative, they should be treated with caution. We note that the determination of appropriate level of public investment in infrastructure to help facilitate economic growth and development have been a major challenge to many countries in terms of the need for fiscal prudence and debt sustainability. While this challenge is acute for developing countries, it is particularly more so, for several debt-ridden sub-Saharan African countries, many of which are "catching up" in forging public-private partnerships (PPPs) for the supply of essential infrastructure. In this connection, staff papers provide a useful in-depth overview of, and conclusions on the experiences of countries that have attempted to accommodate public investment in infrastructure in fiscal targets, while safeguarding macroeconomic stability.

The Public Investment Growth Nexus

Staff highlight that the lack of unambiguous evidence on the relationship between public investment and growth in the pilot countries, while at the same time they observed that individual public investments might generate positive returns. We believe that the issue of aggregate contribution of all such projects to growth in a country might ultimately be resolved through identification and use of suitable analytical frameworks, and their continued refinements over time, since there is inherent difficulty of establishing, with certainty, a one-to-one mapping between a given public infrastructure investment and growth.

Staff indicate that empirical evidence on the impact of public investment on growth is mixed, with positive impact tending to be more robust for developing countries and individual infrastructure projects often generating high returns on investments. In our view, the major problem in this regard, is how to effectively disaggregate the total impact or high returns of individual infrastructure projects on GDP growth. A public sector rural electrification project, for example, could spur value-added economic activities by artisans, welders, barbers, among others, the aggregate of which, could contribute to employment and growth. Staff comments on or reexamination of this issue would be welcome.

We note the findings of the investment climate survey in four of the pilot countries studied, that top-ranked concerns of private investors include high tax rates, economic and regulatory policy uncertainty, microeconomic instability, corruption and the cost of financing, with infrastructure receiving only a low ranking. However, we agree with Messrs. Kanaan and Shbikat, that these findings must be interpreted with caution, because very often, the positive externalities from public sector investment in infrastructure are not captured in the profitability calculations of private investors, but could raise the contribution of private investment to growth. Moreover, as Messrs. Misra and Gauba point out that, there are countries, which have failed to attract investment, despite strong institutions and regulatory frameworks, while others have attracted considerable investment primarily on the strength of high quality infrastructure. This is the case of countries that not only lack adequate infrastructure, and/or macroeconomic stability, but are able to attract high levels of investments mainly because of high profitability of the investments. Nevertheless, the importance of investing in infrastructure should not be downplayed, particularly since the pilot study was based on a very narrow sample.

We agree that there is a need for further work on how countries could improve overall composition of public spending under existing financing and absorptive capacity constraints. Such a work could provide additional insight on a potentially optimal way of balancing the proportion of public spending on physical capital relative to that on human capital. Moreover, like Mr. Alazzaz, we believe that priority should also be given to the maintenance and the rehabilitation of existing infrastructure. Furthermore, we are of the view that institutions should be strengthened to ensure proper management of infrastructure.

Macroeconomic Stability, Debt Sustainability and Increased Public Savings

Options for significantly increasing public infrastructure spending by relaxing overall fiscal balance targets are limited for countries with tight constraints related to macroeconomic stability and debt sustainability. However, we believe that there should be room for more fiscal flexibility to provide more resources for infrastructure, particularly in the case of low-income countries. In this connection we would like to point out that the income levels in many of the Fund’s low-income member countries are so low, making the mobilization of additional domestic resources in the form of increased public savings and revenue mobilization extremely difficult, if not impossible. At the same time expenditure have already been prioritized in line with poverty reduction strategies, supported by the Fund and World Bank. In such cases, we believe that external resources in the form of increased donor assistance have a key role to play, and we call on the developed countries to live up to their commitments and to increase the level of ODA assistance to 0.7 percent of GDP as reiterated in Monterrey. Obviously, such increased assistance should also be directed towards infrastructure development.

Coverage of Public Enterprises in National Statistics

While we agree with staff's call for a comprehensive coverage of public enterprises in national statistics, we are of the view that a gradual movement towards such coverage may be necessary, compared to a "big bang" approach, given the significant capacity constraints currently faced by many developing countries in meeting the requirements of generating and disseminating basic macroeconomic data. In this regard, we also share the view that the particular circumstances of each country should be taken into account. Moreover, we fully share Mr. Steiner's view regarding the restrictive nature of staff's revised proposed criteria on the classification of enterprises as public or commercial.

Public Private Partnerships and Guarantees

We note that in order to lighten the public sector's fiscal burden of providing infrastructure, PPPs involving the provision of guarantees to minimize risks, are seen as a limited avenue for increasing infrastructure investment with improved efficiency. Staff acknowledge that guarantees create problems of contingent liabilities not usually subject to the same degree of scrutiny in the budget process as regular spending, and are associated with uncertainties with potential adverse consequences for fiscal balance and debt sustainability. In our view these guarantees should not, in any case, be included in the fiscal framework and DSA, which is not only consistent with current practice, but most importantly, could open the door for the inclusion of many more contingent liabilities in fiscal framework.

The Director of the Fiscal Affairs Department (Ms. Ter-Minassian), in response to questions posed by Directors, made the following statement:

I will focus my remarks on the general issues raised in the grays, and my colleagues will concentrate on the specific questions raised.

The first set of issues relates to the nexus between public investment and growth. The staff shares Directors' frustration at the lack of robust quantifiable evidence on the relation between public investment and growth. We looked at a broad cross-section of studies that have been carried out on the subject, using a variety of methodologies. The results of these studies, which are reported in the main paper, point to significant differences in the effects of public investment across countries, regions, and sectors. This heterogeneity is likely to reflect several factors, such as initial conditions, in particular the quantity and quality of the capital stock already in place, the quality and efficiency of the flow of new public investment, and complementarities between different types of public investment, including between investment in physical infrastructure and human capital. It is also likely that, as noted in some of Directors' preliminary statements, the impact of public investment on growth will differ depending on a country's level of development and its macroeconomic conditions. Specifically, even a significant boost to public investment may fail to raise the growth rate of a country on a sustained basis if it occurs against the background of severe macroeconomic instability or if it crowds out private investment. That said, the papers do recognize that there are likely to be complementarities between public and private investment in many countries—especially in situations of significant infrastructure bottlenecks—although the evidence from the World Bank survey of investors suggests that factors other than infrastructure bottlenecks are more serious hindrances to increasing investment.

The staff agrees with Directors on the importance of further research on the linkages between public investment and growth. Country-specific or, at most, region-specific studies are likely to yield better insights on this issue than cross-sectional ones. The Fund staff will pursue some of these studies as part of its research program (e.g., FAD and WHD have embarked on a study for Latin America), but the World Bank and other MDBs should take the lead on this subject. I understand that the Bank staff will be soon conducting an informal Board briefing on their work program in this area. The Bank and other relevant institutions should also be expected to take the lead in assisting countries in a number of institutional (i.e., legal and regulatory) reforms, needed to improve the investment climate for the private sector. The Fund staff contributes to these efforts in the areas of its core competencies, such as with regard to fiscal transparency and the design of efficient and investor-friendly tax systems.

On the issue of so-called fiscal space for public investment, we were pleased to note that Directors generally support the staff's view that it cannot be created through changes in fiscal accounting, such as by excluding investment spending from fiscal indicators and targets. Rather, the decision to create fiscal space for public investment should be based on a careful country-specific assessment of (i) how the financing of proposed public investments affects macroeconomic stability and the medium-term debt sustainability; (ii) the trade-offs between higher spending on public investment and either revenue mobilization or cutbacks or rationalization of other types of spending, when additional borrowing is not advisable; and (iii) the scope for better prioritizing and improving the quality of the public investment themselves.

Some Directors inquired about the role of the Fund in addressing these issues in the context of program design as well as surveillance. The pilot studies encompassed both program and non-program countries, as well as one country (i.e., Brazil) that is in transition between the two statuses.

The quality of the policy dialogue with surveillance countries can be substantially enriched by a more detailed and careful consideration of the issues related to fiscal space, composition of spending, trade-offs between tax increases and expenditure increases, as well as the quality of public investment and other spending programs in the context of Article IV consultations. The assessment by the Fund, as reflected in published reports on those discussions, can also help market participants focus more on the quality and sustainability of a country's fiscal policies and fiscal consolidation effort.

The Fund can play also the role of pedagogue vis-à-vis markets and sensitize countries to the need to improve their expenditure prioritization efforts and the quality of their expenditure programs, for example, through outreach seminars as well as by providing technical assistance in the public expenditure management area. Already, the Fund is planning to replicate, in this fiscal year, the outreach seminar recently held in Brazil for Latin American officials, in Asia, Europe, and Africa. However, the Fund must be conscious of resource limitations and look to the Bank, and other, MDBs to take the lead in these areas.

Regarding the proposed treatment of public enterprises, there is a distinction made in the staff report between the coverage of public enterprises in the fiscal statistics and the fiscal indicators and targets. The staff is proposing that, over time, all public enterprises, as defined according to the Government Financial Statistics Manual 2001 (GFSM 2001), should be covered in fiscal statistics. Expanding the coverage of fiscal statistics to encompass all enterprises is likely to take time, and in some cases might require that the legal framework for reporting requirements be strengthened, but it will contribute to transparency and evenhandedness as well as help minimize fiscal risks. To assess the time involved, as well as other requirements for this process, the staff has proposed that mission teams should discuss with the authorities, in forthcoming Article IV consultations, a realistic timeline for extending the coverage of the fiscal statistics, to encompass public enterprises in a way that is consistent with domestic capacity. This approach will also allow us to gauge the need for technical assistance from the IMF staff or other statistical agencies.

A distinct but related question is whether to include public enterprises in fiscal indicators and targets for policy purposes. The staff suggests that the coverage be selective, and that the selection be based on an assessment of fiscal risks. To help in the assessment of such risks, the staff has modified the criteria first proposed in the Public Investment and Fiscal Policy paper a year ago, incorporating suggestions that were put forward by the authorities that participated in the pilots. The criteria have also been modified to determine whether an enterprise should be included in fiscal indicators and targets based on the degree of fiscal risk it poses, rather than based on commercial orientation, which may be less relevant.

The new criteria are analytically sounder, but also more demanding. For this reason, the staff is proposing that this new criteria be tested in a representative sample of countries, including industrial countries. The results of these tests should be reported in Article IV consultation reports. This approach will allow a better assessment of the resource costs and facilitate the preparation of guidelines to help the staff make a judgment on the suitability of including enterprises in fiscal indicators and targets in the event that different criteria provide diverging indications of whether an enterprise should be included or not.

The staff representative from the Fiscal Affairs Department (Mr. Hemming), in response to questions posed by Directors, made the following statement:

In response to requests to provide information on the experience with bailouts of public-private partnerships (PPPs), the early history of PPPs in the 1980s was not very good, especially in Latin America. Many projects had to be renegotiated or bailed out, particularly in Colombia and Mexico. The lessons learned from that experience are part of the reason that the structure of the second generation concessions in Latin America have improved. The more recent wave of PPPs, however, has yet to yield any significant failures, although there is a clear tendency in the literature discussing PPPs—which is largely written by those seeking to promote them—to emphasize the successes.

There have been a few well known problems: the Channel Tunnel Rail Link in the United Kingdom is now explicitly backed by the government, having had financial difficulties; and a major Hungarian motorway has been renationalized due to financial problems. The literature addressing the problems with PPPs mainly focus not on the bailouts that may have been necessary, but rather on whether PPPs have delivered expected efficiency gains. Problems with PPPs, however, tend to be the exception rather than the rule.

There were a number of comments on the Eurostat decision, an issue that was also discussed at the last Board meeting. The staff continues to be of the view that the approach underlying that decision is flawed. The primary concern is with its binary character. As this approach requires that a PPP asset is posted either entirely to the government sector or the private sector balance sheet, it is not sensitive to the extent to which the government bears risk under these projects. It is also based on a limited number of risks, is too lax, and creates bad incentives to select PPPs simply because they are off-budget. Notwithstanding these concerns, the accounting bodies are in the process of developing an international accounting standard for PPPs and the staff is not hopeful that the final approach will be much different from that which underlies the Eurostat decision. At the moment, the best outcome might be simply establishing criteria that are somewhat tighter than those used by Eurostat.

On the question pertaining to the implementation of the Eurostat decision, it is primarily an issue in a few countries—new member states of the EU and those countries that are seeking accession—that are at the early stages of developing PPPs. In particular, these countries are focusing on the characteristics of a PPP necessary for it to be recorded off budget under the Eurostat criteria. The staff is not aware, however, of any country that has undertaken a significant reclassification of its PPP investments in light of the Eurostat decision.

The issue about the differences between accrual and cash accounting in the public sector was also raised. The reporting of PPPs, as with any other complex fiscal operation, will be more thorough in those countries that have adopted a comprehensive statistical reporting framework, such as the Government Finance Statistics Manual 2001. Not only does the GFSM, embody accrual accounting, but it is also based on balance sheets and integrates stocks and flows.

Those countries that have extensive experience with PPPs, such as Australia and the United Kingdom, have also adopted a comprehensive statistical framework. It is not surprising, therefore, that their reporting of PPPs is by far the most thorough. Most other countries with PPPs rely on less comprehensive frameworks, many of which are cash based. Nevertheless, some countries, such as Chile, still do a good job in this regard. It is encouraging that many of the countries that are considering moving towards PPPs are also actively considering moving towards implementing the new Government Finance Statistics Manual.

With regard to the question on the 50 percent criterion, public sector accounting standards require that guarantees be recognized in the fiscal accounts if there is a good chance that they will be called. This has been interpreted as implying that where there is a probability greater than 50 percent that a guarantee will be called, the guarantee needs to be entered in the fiscal accounts. This is an accounting standard, not a statistical standard. Statistical standards, including the new GFS, require that guarantees be recorded when they are actually called (i.e., the 50 percent criterion does not apply to statistical reporting). Moreover, the 50 percent criterion shares the weaknesses of the binary approach discussed earlier. Accordingly, were the criterion to be adopted as part of the statistical reporting standards, there would be a similar lack of sensitivity to the risk borne by government. Disclosure of government commitments and of fiscal risk arising out of PPPs are, therefore, emphasized as the principal objective of fiscal reporting.

On the issue of disclosure of guarantees, in addition to disclosing qualitative information—which has been set out in a box in the staff report—an effort should be made to quantify expected payments in respect of called guarantees. A number of Directors have commented that data availability problems and institutional capacity in many countries will make such calculations difficult. The staff paper explicitly acknowledges these potential problems and offers several alternative interim steps for such countries.

There were several questions on the issues related to guarantees and debt sustainability analysis, and in regard to a particular proposal that one should treat expected payments under called guarantees and contractual service payments under PPPs as future primary spending for the purposes of undertaking DSA. The staff paper makes the point that this approach is formally equivalent to treating the present value of these payments as debt. Debt sustainability analysis could be conducted in either fashion. However, counting either the committed payments under PPP contracts or the present value of the expected value of guarantee payments as a liability is not required under any accounting or statistical standard. The staff's suggested approach, therefore, would not be consistent with these standards.

It is interesting, however, that today's Financial Times reports that the Office of National Statistics in the United Kingdom is about to recommend that liabilities under the private finance initiative be counted as net debt for the purposes of implementing domestic fiscal rules. This raises two interesting questions: (i) which of the many different ways that liabilities can be estimated under the PFI will be used?; and (ii) will the measure introduced in the United Kingdom ultimately be reflected in accounting and reporting standards, and therefore will all countries have to adopt a similar approach? Until that happens, the staff's proposal is to treat payments—both in terms of contractual obligations and the expected value of guarantees—as future primary spending. To correct an observation made in a number of Director's statements, there is no suggestion that, in doing this, implicit contingent liabilities will be taken into account in debt sustainability analysis. However, although the focus in this regard is explicit guarantees, for a more comprehensive fiscal risk assessment, implicit guarantees should be taken into account in making assessments of fiscal sustainability.

On the question of whether there is an implicit government guarantee behind private firms that are "too big to fail," I would respond that there is. So, if the risk is significant and the implicit guarantee is large, then this should be taken into account in more comprehensive fiscal risk assessments.

On the issue of setting overall limits on guarantees, the staff report notes that such limits are fairly common. The staff's view, however, is that overall limits on guarantees are crude, since they are not sensitive to the likelihood that guarantees will be called. A limit on expected guarantee payments, where the debt sustainability analysis suggests guarantees pose a significant fiscal risk, is more appropriate, as it is sensitive to the degree of risk. PPPs also pose more general fiscal risk, but limiting the size of an overall PPP program would again be a crude form of risk containment. The staff argues that, in countries where the debt sustainability analysis points to its appropriateness, a limit also be applied to contractual service payments.

There were also some comments on provisions for guarantees, another area where statistical standards need to be differentiated from accounting standards. Unlike statistical standards—where guarantees need to be called before they are recorded in the fiscal accounts—accounting standards require provisioning for expected calls on guarantees if it is more likely than not that a guarantee will be called. In the staff's experience, those countries that clearly provision for guarantees also budget for guarantees, and since budgeting for expected calls on guarantees is effectively the same as provisioning for them. The paper provides examples of what is done in Colombia and in the United States, which differ in that, in Colombia, funds are set aside to cover the cost of called guarantees in addition to provisioning.

There was another question related to the recommendation that PPP contracts be disclosed. The disclosure of contracts is needed in order to determine the long-term financial implications of PPPs, both in terms of contractual service payments and potential calls on guarantees. The disclosure of public procurement contracts is fairly commonplace, and the recommendation to disclose PPP contracts has proved largely uncontroversial. The issue has not so much been whether contracts should be disclosed, but how. These contracts are generally rather lengthy documents, filled with legal jargon. The question is whether some standardization of contracts should be introduced, and whether they should made public along with summaries of their implications.

There was also a question related to the debt sustainability analysis (DSA) for Uruguay. The DSA for Uruguay does stress testing for potential bank restructuring costs, but in successive staff reports the nature of the tests that have been done was changed. For example, in one report the DSA focused on the total cost in the event that all government guarantees given in connection with bank restructuring were called, while a subsequent report focused on one particular at-risk financial institution. The question was asked, specifically, if there is an inconsistency as a result of this progression. In fact, the DSAs are seen to be consistent, although they focus on different things. But guarantees do involve a new, more complex sphere of analysis. It is as important to document and explain exactly the analysis as it is to conduct it, so that it may be more fully comprehended.

There was a question relating to World Bank guarantees in respect of government payments to private suppliers under investment contracts involving the private sector. These are essentially counter guarantees. The government may guarantee the return to a private partner under a project, then an MDB—the World Bank or the IDB—steps in and provides a counter guarantee. This is an enhancement that is meant to overcome policy and regulatory risk or reputation problems with the goal of helping the private partner access financing on better terms. Although these enhancements can be a useful tool, transparency will be imperative. In Peru, as well as some other countries, this type of counter guarantee is treated as a sovereign guarantee, which is realistic because it is the government ultimately that has to pay back the MDB. In fact, it is a counter-counter guarantee, and that treatment seems to be appropriate.

On the coverage of public enterprises, Table 9 of the main staff report includes an analysis of the commercial orientation of public enterprises. It is noted there that many enterprises do not meet the managerial independence criterion to qualify as a commercially run enterprises. If, in response to one Director's question, that criterion were discontinued, of the 115 enterprises, 35 (rather than three) would be classified as commercially run. A number of those 35, however, would pose a serious fiscal risk.

For example, in the initial test, no enterprises in Peru qualified as commercially run. Were managerial independence to no longer be a criterion, 13 would qualify; however, a number of these enterprises are heavily unionized, and the risk is that if fiscal constraints on these enterprises were relaxed, then wage discipline would collapse. So, there is a risk. Simply relaxing a criterion because it disqualifies a large percentage of enterprises from being classified as commercially oriented is not the way to go. As has already been discussed, and as the literature supports, the emphasis should shift from applying a simple rule to determine the commercial orientation of an enterprise to making a judgment on the fiscal risks it poses.

On a provisional basis, the staff tried this revised approach for the pilot countries. It appears likely that a number of additional enterprises that would not pass the commercial orientation test would qualify for exclusion on the basis that they do not pose a large fiscal risk. There are about 12 such enterprises in total, including Petrobras in Brazil, Ecopetrol in Colombia, three enterprises in Peru, two enterprises in Jordan, and three in Ethiopia. This was a rough and ready application of the approach we are proposing, but it does suggest that more enterprises will qualify for exclusion from fiscal indicator targets on the basis of this new approach.

With regard to the emphasis that the staff places on the importance of assessing the returns to government from public investment projects, returns to government are the user fees on infrastructure and the taxes collected from the higher growth that is generated through the investment in infrastructure. In other words, this is the government's return to investment, and it is critical to determining whether the fiscal space, especially for economic infrastructure, should be made. It is the basis—by generating user charges and higher growth—on which the investment pays for itself. It is also critically important from a debt sustainability analysis perspective. For projects that do not pay for themselves—and this would probably apply to most social infrastructure and some economic infrastructure projects—the issue then is whether the returns not captured by the government (i.e., the social returns) justify the implicit subsidy that is being provided to the project. So, it is important to know the returns on the government investment.

There was also a question about the comparison between the U.K. golden rule and Chile's structural surplus rule, specifically in regards to the merits of each. There are many interesting technical differences between these two rules in terms of what they imply for steady state debt. They both apply over the cycle, but in different ways. The most significant difference is that the golden rule attaches explicit importance to public investment, but determining the room for public investment under both rules involves paying attention to precisely the same macroeconomic considerations, in particular the need to maintain a moderate or declining debt ratio. They also call for the same types of fiscal policy prioritization decisions. The staff is preparing a set of papers for Board discussion on the general theme of promoting fiscal discipline, which will consider both of these rules in more detail.

Finally, in the India pilot study, the staff had a somewhat negative response to the authorities' proposal to use a small portion of foreign exchange reserves to finance infrastructure, because it implies an increase in the fiscal deficit and India has recently introduced a fiscal responsibility law. The Fiscal Responsibility and Budget Management Act sets specific targets for the fiscal deficit, with a view to bringing down the presently high level of the deficit and debt.

The authorities' proposal would have required an adjustment to the targets under the Fiscal Responsibility Law in its first year, and risked damaging the credibility of the law by sending a negative signal about the commitment of the authorities to reducing deficits and debt. In addition, it would be also a return to monetizing the deficit, and this would have reversed the progress made over a number of years in reducing monetary financing of the deficit, which has played a major role in lowering inflationary expectations and interest rates. It was not worth putting these gains at risk by undertaking this particular transaction. There is also a risk that it would undermine the independence of the Reserve Bank of India and create an undesirable precedent.

The staff representative from the Fiscal Affairs Department (Mr. Schwartz), in response to questions from Directors, made the following statement:

There was some question as to whether foreign investors participated in the World Bank Climate Survey. To clarify, the survey includes both domestic and foreign investors, as well as a broad cross-section of enterprises "including exporters, foreign-owned firms, and those who have recently adopted new technologies." Hence, there is a cross-section of enterprises participating in the survey: foreign and domestic, as well as large and small. Given that a number of developing countries have a large number of small enterprises and few large enterprises, however, there is a tendency to oversample somewhat the large establishments. In some cases, these large establishments are foreign owned.

There was a question asking how infrastructure indicators could have improved when investment was falling. The overall public sector investment fell more sharply—as well as earlier—than infrastructure investment. Public sector investment began to decline from 1990–91 onwards, and, by 2000–03, the annual rate had dropped almost 4 percent of GDP. Infrastructure investment did not begin to decline until 1996–97, and fell by only 1 percent of GDP by 2002. The sharpest improvement in the indicators was in the telecommunications sector, following deregulation; private sector investment began to rise significantly in the second half of the 1990s, which explains the improvement. There was also some pickup in private sector investment in other infrastructure sectors, mainly roads. Keep in mind, however, that the improvements in this sector are over a very low base, particularly compared to some other countries that are shown in this table.

In answer to the question on footnote 13, there is a sample selection bias, as the data refer only to infrastructure projects, and, even then, only to those infrastructure products that have been successfully implemented according to World Bank criteria. The World Bank data suggest that the percent of total projects that have been successfully implemented range between 70 and 90 percent across sectors, with average successful implementation rates that are not very different for infrastructure and for non-infrastructure projects (i.e., 75 versus 76 percent respectively). The World Bank data on economic rates of return, however, are only available for infrastructure projects and are not available for non-infrastructure projects. Hence, there is no direct comparison between the economic rates of return possible between those sectors. The sample selection bias, therefore, could not be circumvented.

Mr. Steiner made the following additional statement:

I appreciate the clarification that the idea of expanding the debt sustainability analysis is not in reference to a broad and ill-defined concept of implicit liabilities, but to a well-defined concept of expected payments on called guarantees. In spite of that, I agree with Mr. Duquesne that we have to be cautious in the methodology. I would anticipate that it is not going to simply be another line in the DSA table. A lot of explanation needs to be provided. I do not know what details staff has in mind, but it is a process that should just begin, and we would eventually come back to see how the methodology would be applied. To move in that direction (for which there appears to be quite a lot of support), a cautious approach should be taken and detailed explanations should be provided.

I welcome that the new pilot program envisaged by the staff will include developed countries. I, and some of my colleagues—for example, Mr. Ondo Mañe—regretted that the pilot programs have not so far included developed countries, in particular, Eurostat subscribers. Such pilot studies can be instructive, and it is unfortunate that these countries did not volunteer to participate. The new pilot program would be enriched by broader participation.

On the issue of capping PPPs, I support the view of the staff. Although there are many positive aspects to PPPs, including that they could provide reasonable solutions for countries that have problems in delivering adequate levels of infrastructure, there are risks, particularly in that they could move what would normally be budget items offline. The report on the pilot projects, however, refers to two countries—Chile and Colombia—that have gone a long way in doing the right things. Certainly Chile, and Colombia probably in a lesser fashion, have provided good, prudent fiscal frameworks.

The Fund, who is always perceived to be a policeman, should play the role of providing positive incentives. It would be unfortunate if a country like Colombia, which has a good framework and conducts good budgeting of guarantees, is restricted in the amount of PPPs it can undertake. Rather than telling such countries that they have to restrict PPPs, the staff's time is better served in following up on the framework and making sure that it remains solid or improves. It would be unfair to follow a blanket policy of suggesting caps on PPPs. Other Directors have given good reasons as to why that would be a bad idea, and I appreciate that the staff has taken these comments on board.

I would like to clarify the response to a question posed in my preliminary statement, which did not receive an explicit answer from the staff, although it was alluded to in the Petrobras and Ecopetrol references made by the staff. Specifically, might those concerns might eventually be excluded from the public sector? I understood that, with regard to quasi-fiscal activities, in the case of Ecopetrol—this came up a couple of weeks ago in the discussion on the Article IV consultation with Colombia—when an oil company provides a domestic subsidy for gasoline, if it is transparent and fully reflected in the fiscal accounts. It would be a poor basis, therefore, on which to consider such a company to not be commercially run.

So, although the staff did not say so explicitly, I presume that the answer to my question is that if a company undertakes quasi-fiscal activities that are duly accounted for, the simple existence of those quasi-fiscal activities would not be a reason to include that company as part of the public sector.

Mr. Misra made the following additional statement:

First, I must compliment the staff for carrying out a very strenuous effort. Though I am personally not satisfied about the direction in which we are going, the effort was certainly strenuous and detailed.

Now, it has been raised in many grays—and certainly in ours—that the paper raises more questions than it answers. Firstly, and the staff representative has already clarified some of these issues, the consequences and causes of decline are not known; nor is the effect on the extent of decline in growth known. I am happy with the clarification that the staff representative provided with regard to the revised approach on the inclusion of public enterprises in fiscal indicators, which is much more logical. The most important drawback of the staff note is that it does not indicate what was the Fund-supported program's role in program countries leading to the decline. What I am trying to stress is that if the Fund-supported/Bank programs also led to lesser investment and, therefore, decline in growth, by taking a decision now, based on the pilot study instead of studying the matter further, are we going to again replicate the same deleterious impact and rue after ten years?

Further, what bothers me is that the studies are of disparate countries, with no linkage in the legal and constitutional structures, the kind of politics, (viz., democracy/nondemocracy), and the kind of formats that they have. Instead of conclusions flowing out of the pilot studies, as it ought to, all the conclusions are actually flowing out of the voluminous available literature that are reported in the Annex to the staff paper.

We looked at eight or nine countries. There could have been 150. As previous speakers said, no developed country was included, even though we had decided that the country must opt for it. We were one of the countries which so opted. From nine countries, we have not been able to come to any particular conclusion. We are relying largely on the existing literature. This is important because instead of studying further, or arriving at different kinds of conclusions, different probabilities that can be there in different systems (maybe we can have three alternatives, and a country could opt for one of the three), what the staff are suggesting now is that it becomes another component of the Article IV rigor. Why the rigor? The way Ms. Ter-Minassian puts it is that it is a signal to the market. For example, here is the Report of the General Accounting Office (GAO) of the U.S. The Treasury in its evidence, states there are certain deficits in accounts. I do not mean to be critical of the U.S. Some deficiencies are there in every country. Let us see the report on India, for example. I am not particularly interested in what would happen in India but interested in the analysis that flows from it. It is clearly indicated that the municipal finances are not reflected anywhere. From my experience as the Mayor of New Delhi Municipality (five years back) it had a surplus of half a billion dollars, but it is not being reflected anywhere in the General Government accounts. The issue is: can all the municipalities' accounts be reflected in the country's General Government account in one year? Ms. Ter-Minassian has already explained that one needs time for that. The staff report also says that only for water supply and transportation, the investment in municipalities would require US$85 billion. What would happen, therefore, if we include these accounts in the Article IV? We want to attract investors. Who would be willing to invest in these countries when we give a negative picture in the Article IV. Since no investor would be attracted, it would ultimately lead to no investment and the utilities will only get worse. We would be repeating the same exercise ten years later.

When my country opted for this study we thought that the conclusions would be more like a guiding post; we study eight or nine countries, we see what kind of systems are operating, what kind of advice can be given, look at alternative scenarios, and ultimately it would be for the country to accept and adopt one of them. In the course of the next few years, it will be seen whether a country is opting for the right course, and in every Article IV the country can be advised it is not going on the right course. Another example, a surprise to me, because I did not know this about India is that 60 percent of the investment projects in India had cost overruns in the 1990s. In 2000 it came down to 20 percent. There is no quantification of what are the gains from this reduction from 60 to 20 percent. If it was not 20 but 5 percent, we can conclude that better projectization, better conceptualization, better operational monitoring would improve matters and enhance growth.

We are talking about accrual accounting with all the public sector being included, and multi-year budgeting. They are all good. But in no system can it be done in one year. The government has to go to the Parliament to change the whole system, then amend the constitution to bring the states in and also amend the constitution further to bring the municipalities in.

Since I do not know about other countries in such a detailed fashion, I am giving an example of the kind of imponderables that we are getting into. Until we address that, if the Article IV reflects 'deficiencies,' I think we would get into trouble, and also repeat the same mistakes which the earlier Fund program might have led to. Some of the questions that have been asked, but not been addressed in the report are; (i) did Fund/Bank programs lead to decline in public investment because of fiscal sustainability factors; (ii) could it be due to undue stress on social sectors instead of infrastructure for ten years. I am not saying there is an easy answer to these questions; but the questions must be addressed.

As Mr. Steiner asked, would this be reflected in developed country cases. Can we really do it or soon will we find that program countries are being now brought into the fold and in the case of the developed countries or non-program countries, nothing much can be done. We find from the General Financial Statistics in 2001, a large number of developed countries also do not conform to the standards. Can we do anything about it? All that I am requesting at this stage is that this subject needs much further study, and a country should be able to select its own options. Let's not think again of India, Brazil, and Chile that are emerging market economies and large countries. There would be any number of countries, a hundred at the least, that would not have the technical capacity to manage this.

Ms. Jacklin made the following additional statement:

On the World Bank survey, it struck me as counterintuitive that infrastructure was not a significant issue for investment decisions. Might it be that businesses first have a set of screening criteria, which include infrastructure considerations and other basic considerations, that drastically reduce the number of countries they are considering for investment? Then, the World Bank survey is not reaching companies at that point in the decision, but after that initial decision has been made.

For example, investment into an aluminum plant, will require a means to transport the product to the port, water to operate the plant, and a workforce capable of producing the desired output. Using this criteria, there may be four or five geographic locations which satisfy these requirements and among which a potential investor will choose. It may be that the World Bank survey is canvassing investors at that point in the decision process. It cannot be that infrastructure does not matter as a primary motivator of where a plant or other physical investment will be located.

It would be useful, therefore, to improve our understanding of how the World Bank survey is being conducted and at what point in the decision process the responses to questions are being provided. Really, an investment decision is not made until after the field has already been considerably narrowed, after they have been identified as even being viable.

On another issue, it would seem a rather hopeless goal to try to create a standardized contract or template for considering PPPs. In each PPP, the potential players change. Some may include export credit agencies, for example, others may not. Each may also have different standards for what they will or will not do, which can then affect how the transaction is structured. Different amounts of equity coming into the deal would also vastly change the structure of the PPP. As well, legal systems differ across countries.

I also appreciate the staff's caution as to how to carry the project forward with regard to public enterprises, but is it necessary to analyze the risks for each enterprise and make a determination as to whether they should be included as public enterprise or not? Will all of these really be macro-critical? Large public enterprises that have the potential for large calls on fiscal resources need to be considered, but is it not better to spend the time looking at PEs that have resulted in either substantial increases in government revenue or substantial calls on government resources to try to understand better where are the potential impacts of a macroeconomic significant level? Approaching this from an overly detailed level would have enormous time implications.

Along these lines, to some extent I agree with Mr. Misra. Using the Article IV consultations may be a too detailed look already at this stage in our learning. It could be valuable to step back and look at public enterprises as a whole and identify where the impact has been the most significant. Small mistakes can be instructive, and should not to be avoided at all costs. The focus should be on identifying potentially large failures.

Mr. Kruger supported Ms. Jacklin, and made the point that every public enterprise infers some risk or uncertainty to the public purse: it is the case when a public enterprise receives a government subsidy, but even profitable enterprises could be a drain on the public purse should the economy cycle downward. There could, therefore, be two broad measures of government. One narrow, based on the "pick-and-choose" judgment method, and the other broad, which would be used for the statistical exercise and would encompass all of the public sector. Although there may be some data missing, such an approach could be more cost effective and reduce the need to make the difficult judgment as to whether an enterprise is commercially run or not.

Mr. Solheim made the following additional statement:

I am in broad agreement with the recommendations and guidelines proposed by the staff. I also agree with Ms. Jacklin and Mr. Kruger that there are risks as well as a limit to how far we can go in this area. I welcome that the staff would also look at the experiences of the advanced countries, because many, not least my own country and the Nordic countries in general, have many experiences—both positive and negative—with PPPs and PEs, which can be instructive for other countries.

On the issue of the importance of disclosure, it may be difficult to determine how far one should go. The Fund and other institutions should assist the authorities and provide the appropriate guidance. However, it is not only important that the authorities communicate to the markets on guarantees in a transparent fashion, it may be as important that they also convey when there is no guarantee, implicit or otherwise.

In my country, for instance, there have been cases where the markets have assumed that certain PPPs and public enterprises had government guarantees, even when they in fact had not. These companies and enterprises had easy access to capital markets, but when they ran into problems, it was still expected that they would pay out. The government did not step in the end, but there were many legal proceedings in the interim. It proved to be a good lesson for the market. The importance of communication could have been even further emphasized in the staff papers, including clarifying that there would be no public pay out.

Mr. Murray made the following additional statement:

Ms. Jacklin made some good points with regard to the World Bank Investment Climate Survey, specifically with regard to the question of at what stage in the investment process the questionnaire was reaching respondents. The staff should follow up on this line of investigation.

On the declining trend of public sector investment, is it is not only countries with IMF-supported programs that are experiencing this decline: so too are industrial countries. It is partially attributable to increased privatization and, more recently, efficiency gains, but fiscal discipline has also played a role. The existence of fiscal rules has meant that governments appear to see quicker returns come out of recurrent spending decisions rather than longer term capital investment decisions. The presence of IMF-supported programs should not be attributed with causality.

On public enterprises, we support in our preliminary statement a move toward including the consideration of public enterprises in risk exposure in various general government indicators. After today's discussion, however, I am unclear of what the Fund would be doing in the Article IV reviews. It seems that the Fund would be really playing a role akin to a domestic central agency, such as a finance ministry or budget department, where each of the public enterprises would be considered. This seems a detailed, micro-level undertaking. The suggestions made by Ms. Jacklin and Mr. Kruger perhaps should be followed up, as there may be a more simple indicator.

On the issue of the disclosure of guarantees, this is a difficult area. Australia has been looking at how to disclose quantitative guarantees and contingent liabilities. The difficulty with the data is in convincing ministers that the probability distributions are actually concrete and a sufficient basis on which to incorporate the figures into the budget.

Finally, on PPPs, here again Australia has done a lot of work—both at the federal and provincial levels—on the disclosure of the risks and quantifying the transfer of risks to the private sector. It is a difficult task, even with significant institutional capability, and it takes up a lot of resources. I, therefore, share Mr. Misra’s concerns, but it is also important in this exercise to construct a public sector comparator. The public sector comparator in Australia has focused ministers’ minds on whether to go ahead with PPPs or not. There has been a lot of early enthusiasm for PPPs in Australia, particularly at the provincial level, where most of the investment is taking place. However, translating that into actual projects has now slowed considerably, as ministers carefully consider the extent to which the transfer of risks is really proposed in particular projects.

Mr. Steiner asked for clarification on the issue of coverage. It had been his understanding that the staff would look at all public enterprises, but not at a micro level. According to paragraph 37 of the staff report, the goal was to identify those major public enterprises which posed a sufficiently large fiscal risk to public finances. It would be similar to extending the pilots to all Fund members, and, as the pilots seemed to be a well-defined process, it was an entirely appropriate approach.

Mr. Gola emphasized that the World Bank and other development institutions, as appropriate, should take the lead where they have a comparative advantage over the Fund, namely in developing cost-benefit analyses. Second, the Fund should approve a guideline that would see governments more involved in PPPs provide an estimate of contingent liabilities on a regular—perhaps yearly—basis. Third, the potential costs of PPPs should be incorporated in debt sustainability analyses.

Mr. Kanaan made the following additional statement:

I would like to support Ms. Jacklin's observation on the World Bank Investment Climate Survey. It is an important point given that the concluding section of the staff report mentions that public infrastructure services rank at the bottom of investor concerns in those surveys. Often, in private investors’ calculations, the positive externalities from public investment are not captured as easily as some of other financial aspects of the decision, including, for example, high tax rates, which the staff identifies as a potential major bottleneck, and graft. The staff should, therefore, be cautious in interpreting the results of the survey. The role of public investment may be underestimated in the survey, and may have an important impact on growth, under the right conditions.

With regard to the broader point on the links between public investment and growth, the cross-sectional studies should be complemented by individual country case studies, in which other constraints to growth are examined to determine the conditions under which public investment could be more conducive to growth.

On the question of the assessment of the fiscal risks of enterprises, the staff's position seems to be that, instead of actually aiming at including all public enterprises in the fiscal targets, given the debt limitations and that the broadening of the coverage of statistics would take a lot of time, it is just as important to look at whether or not there are public enterprises that *a priori* could pose high fiscal risks. If there is a presumption of high fiscal risks, then further examination is warranted, and, if necessary, the fiscal targets may be adjusted accordingly. That is my understanding of the staff's suggestion.

Mr. Raczko made the following additional statement:

On the issue of the relationship between the rate of growth and the level of public investment, it may be that this relationship is a non-linear function, so that the independent variable affects the dependent variable more profoundly in low-come countries than more mature countries, such as Switzerland. It may be useful, therefore, to identify the point at which this switch occurs. Additional studies along these lines should be undertaken by the Fund staff by, for example, looking at European countries, such as Greece and Portugal, prior to their accession, as well as some of the recent accession countries to the EU. The objective should be to identify the most crucial conditions which may define the turning point of the influence of public investment over the growth rate.

On the issue of the influence of public investment on fiscal sustainability, any kind of guarantee or PPP, treated as a guarantee from the government point of view, should be taken into account in debt sustainability analysis. Looking at the issue of the state guarantee in particular, there may be an additional dimension of the issue that needs to be considered. That is, what would be the apportionment of risk between the state and private sector? There is a tendency to assume that when the state guarantee is made, the risk should be transferred immediately and fully to the state sector. But, it would be more appropriate to look at how to allocate risk between the two sectors.

The staff representative from the World Bank (Mr. Rajaram), in response to questions posed by Directors, made the following statement:

> The three papers being discussed today on public investment and fiscal policy are a welcome and useful input to an expanding debate on fiscal policy and public expenditure and their contribution to economic and social objectives. The World Bank staff were invited to join the IMF missions to the countries in which pilot application of the 2004 approach to the accommodation of infrastructure investment in the fiscal framework was attempted. We would like to take this opportunity to express our appreciation for the collegial and professional exchange of views between the Bank and the Fund that has marked the work on these papers.
>
> There are a number of conclusions and lessons derived from the application of the framework that are sound and with which we can identify. These include the need for countries to increase public savings to sustain higher public investment and the need to strengthen institutions and regulatory development, both to select and implement public investment and to increase the flow of private investment. We share the preoccupation that led to this work; namely, the importance of effective public investment for sustained growth and progress towards achieving the MDGs.
>
> While the focus of these papers on infrastructure investments was appropriate, the World Bank believes that the composition of public expenditure more broadly has an important impact on economic growth and its related objectives, such as the MDGs. A better understanding of the impact of different kinds of expenditure at different stages of the development process is necessary to provide the basis for improved advice on budget prioritization. The Bank intends to begin a program of work to explore further the implications of the composition of expenditure for medium-term growth and the attainment of the MDGs. We will be briefing the Bank Board next week on the Bank's proposed work on these issues, and have invited our Fund colleagues to brief them on the results of today's deliberations.

Mr. Duquesne made the following additional statement:

> If I may, I have in my possession those slides that will be used for the technical briefing at the Bank. The titles of these slides, for example, "Infrastructure Spending has been Declining," "HIPC Emphasis has Protected Social Sectors, But Not Infrastructure Spending," and "Private investment Infrastructure is Disappointing," seem to imply that the Bank is more pessimistic than the Fund on this general issue. I am inclined to agree with Mr. Misra that there is probably a link between the decline of public investment in some regions and the existence of Fund-supported programs. Some may refer to it as "fiscal discipline," as Mr. Murray did, but when fiscal discipline is linked to a Fund-supported program, the Fund also has the responsibility to see if the fiscal

discipline is not overly skewed, for example, toward cutting investment rather than cutting wages.

> I am, therefore, disappointed that the Fund staff report does not explore the link between public investment and Fund-supported programs, an idea that was initially put forward by my Brazilian colleague. I would have preferred a Fund document more along the lines of the Bank's thinking, as conveyed in the briefing material that I have just shared with you. It seems to focus more on the content of programs, including whether there is a need for fiscal discipline. Is it legitimate that fiscal discipline is essentially geared to cutting investment? Probably not, if development is the overriding priority.

> Finally, there is a general feeling in the Board of the Bank that the Fund is to a certain extent responsible for the observed decline of public investment.

Mr. Yakusha asked if the World Bank is scaling back its work on public expenditure reviews.

Mr. Kruger considered that it was the responsibility of the Fund staff to set a fiscal framework consistent with debt sustainability and that of the country authorities to prioritize expenditures within that framework. To say that Fund-supported programs were responsible for a decline in public investment and growth was an unsubstantiated leap of faith. In the case of India, infrastructure spending had declined at the same time that infrastructure indicators had increased significantly, the implication being that expenditure prioritization was critical.

Mr. Duquesne responded that, although the responsibility ultimately resided with the authorities as to what decisions should be taken with regard to expenditure prioritization, it was not inconsistent to ask for a review on why public investment had been trending down.

The Acting Chair (Ms. Krueger) considered that although there might be some scope for study as to the appropriate balance between public sector investment on infrastructure and other spending, today's discussion was meant to address the question of whether public-private partnerships could be undertaken in a fiscally responsible way, so that the envelope to accommodate them might be broadened in a responsible way.

Mr. Steiner made the following statement:

> The staff representative also mentioned the issue of bottlenecks, which deserves more attention. Mr. Duquesne is right in recalling that the idea for this initiative was a Latin American one, but it was closely associated with the conviction that important bottlenecks had arisen, to a great extent, in connection with Fund-supported programs. The staff report goes some way in addressing this question.

> We can discuss, from a philosophical point of view, whether investment generates growth or whether public investment is good for growth or what the

World Bank survey is reveals (Ms. Jacklin raised some good points in this regard). The bottom line is that program countries with inflexible budgetary processes and high tax rates have had to curtail investment spending in some critical areas. The resulting bottlenecks, be it with regard to airports in Brazil or highways in Colombia, have no doubt hurt growth. The pilot programs identified those problems and provided good solutions, although probably only partial solutions.

Mr. Sembene made the following statement:

My chair associates itself with the view expressed by Mr. Duquesne and supported by Mr. Steiner. A lack of fiscal discipline is not the only reason behind the declining trend in public expenditures and infrastructure investment. Low fiscal revenue and pressing social needs continue to prevent an increase in public savings in low-income countries. Under these conditions, and in the context of fiscal adjustment, an emphasis on expenditure prioritization is necessary but not sufficient to create the room needed for additional public investment. The productivity of public investment should be increased, particularly through the strengthening of implementation capacity and project appraisal.

Mr. Gola stressed that the discussion pointed clearly—in that the Fund needed important input from the World Bank and similar institutions, namely comprehensive cost-benefit analyses—to the need to increase coordination between the World Bank and the Fund.

Mr. Miyoshi made the following statement:

There are clearly differing views on the issue of fiscal adjustment and its impact on public investment. I, myself, had a difficult time drafting the statement for my chair, as the comments from my Bank colleagues are rather different from the prevailing view in the Fund. It will be important for the Fund or the Bank (or both) to look further into the benefits, costs, and risks of infrastructure investments. In this context, I thank Ms. Jacklin for her valuable comments on the interpretation of the World Bank survey—perhaps respondents had indeed already narrowed the field of potential investment locations before responding to the survey.

I agree with Mr. Kruger that if the overall debt sustainability or macro stability is at stake, it is the authorities' responsibility to choose how the fiscal adjustment should be achieved, or to choose what expenditure items need to be cut. Although the existence of Fund-supported programs does have some impact on the decline in public investment, at the end of the day, the decision on how to ensure debt sustainability still resides with the authorities. It is appropriate, therefore, for the World Bank to look at the implication of the composition of expenditure on medium-term growth. The World Bank should be expected to take the lead on this point—the competition of expenditure rather than aggregate fiscal policy. I look forward to the World Bank following up on this issue and also on their feedback to the Fund work.

Ms. Jacklin associated herself with Mr. Miyoshi's remarks.

Mr. Bischofberger agreed with Messrs. Kruger and Miyoshi that the burden of fiscal adjustment resided with the authorities, although the Fund could provide valuable input in the decision making process. Fund financing, however, was not the ideal way to address bottlenecks in public expenditure.

The staff representative from the World Bank (Mr. Rajaram) considered the Fund staff's report to be a useful first step in identifying some of the key issues that were part of the debate on fiscal space. There was, however, need for a additional analysis of how the composition of public expenditure affects growth. The Bank intended to dedicate analytical effort to this question over the next couple of years.

The Director of the Fiscal Affairs Department (Ms. Ter-Minassian), in response to additional questions from Directors, made the following statement:

> The staff papers on the issues of public investment papers have moved the debate forward. As Mr. Steiner said, the staff papers have put the emphasis on the quality of fiscal adjustment, not just the quantity, and have looked at issues of how fiscal space can be created in a responsible manner. We agree, however, with our World Bank colleague that the agenda is unfinished. Many questions remain to be addressed, including on the composition of expenditures, which is of paramount importance. Some other areas that might also be further explored are the relationships between public investment and growth and debt sustainability.
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> We will look to the Bank to take the lead in assessing the medium-term implications for growth of expenditure composition issues, but the Fund can undertake further work in this general issue area, as part of its research program. In particular, we can undertake country-specific studies, which, although time consuming and demanding—they certainly could not have been done in the course of a few weeks' mission in eight pilot countries—will be important and more revealing than cross-sectional work.
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> With regard to the role of Fund-supported programs in explaining the decline of public investment in different countries, the answer is dependent on country circumstances. Countries that were faced with a strong needs for fiscal adjustment and that had substantial rigidities in current expenditures were pushed more into cutting investment. The fiscal adjustment would, however, have been as necessary in the absence of a Fund-supported program as with its presence. In many cases, the existence of a Fund-supported program, by supplying resources, in fact reduced the need for financing and even facilitated the flow of capital, thereby easing the burden of adjustment rather than increasing it. That said, there is scope in program discussions to address considerations of the quality of

adjustments and preserving adequate fiscal space for investment in circumstances where the public investment bottlenecks are clear and particularly acute. It could be facilitated by, for instance, introducing in Fund conditionality a complementary current balance target in addition to a target on the overall balance.

Mr. Steiner's understanding on the issue of quasi-fiscal activities is correct: an enterprise may be considered to not pose substantial fiscal risks and be commercially run if it carries out quasi-fiscal activities which are transparently—and in a nondiscretionary fashion—compensated through budgetary transfers.

With regard to the cap on PPPs, such limitations should be applied only in cases where the debt dynamics, including the projected costs of PPPs, indicate an adverse trend. They would not necessarily be routine in Fund-supported programs, nor would they necessarily be recommended in a surveillance context. Brazil is a good example of the nuances of this approach. Brazil, by putting a limit of one percent of revenue per year on future costs of PPPs, is seeking to avoid, at this early stage of the PPP initiative, preempting too much of the future fiscal space. This limit may be revised down the road as the PPP program evolves, but it seems a cautious and appropriate approach to start with.

On the issue of the World Bank survey, we will take another look at its structure. I would also note, in this connection, that ultimately an investor's judgment on whether to go into a country depends on its calculation of all the factors that would affect its future rate of return. It is quite possible that a country that has relatively poor infrastructure offers benefits in other areas—for example, in terms of the tax treatment for those investors—and that this may be a more important factor in the investment decision. That said, we do not advocate that countries offer generous tax holidays to offset the impact of poor infrastructure.

With regard to the issue of the standardization of contracts for PPPs, as complicated as these contracts are, certain features may be extracted and used for assessing fiscal risks. It would be important, however, to definestandardized disclosure requirements as we acquire more experience, including through our TA activities and through our the outreach seminars, which have tapped experts from countries, like Australia and the United Kingdom, more experienced with PPPs.

On the question of the extent to which public enterprises should be included in fiscal indicators and targets, their coverage in fiscal statistics should progressively become fully comprehensive.

As regards the assessment of the fiscal risks, consideration of the size of the enterprise is included as a criterion precisely so that the staff does not engage in an analysis of many small public enterprises which, in aggregate, are unlikely to place significant fiscal risks. The intent is to focus on those enterprises that are likely *prima facie* to pose more significant fiscal risks. But, as the coverage of the statistics improves and we gain more experience with these criteria, then we might progressively extend the analysis of fiscal risks to other enterprises. I would stress, however, that more work on the application of the criteria to a representative set of public enterprises, is required to assess the resource costs for the staff and countries in this kind of analysis. We propose, therefore, that these issues be looked at in the context of the special issues paper associated with Article IV consultations, so that we might take stock of the experience in a representative sample of countries, including industrial countries, and report to the Board a proposed strategy forward in this area.

Although I would agree that there are non-linearities between public investment and growth, it is not clear that the impact of public investment on growth would be lower in developing countries. On the one hand, the capital stock in these countries is generally lower, and therefore one would expect that the additions to it would be more productive. Then again, it is also possible in these countries that the quality of the additional investment may be lower than industrial countries, and more generally that the macroeconomic and the governance environment may be different. Ultimately, it is difficult *ex ante* to anticipate where the impact of additional public investment on growth may be stronger, which points to the need for further studies in this area.

The staff representative from the Fiscal Affairs Department (Mr. Hemming), in response to additional questions from Directors, made the following statement:

To follow-up on the issue of the coverage of public enterprises, the reality is that, by virtue of being a public enterprise and being owned by the government, all public enterprises are a source of fiscal risk. The issue, therefore, is exactly the one Ms. Jacklin raises: which public enterprises are the big problem. It is also the issue, by no coincidence, that we are focusing on.

Our concern is the potential impact of public enterprise operations on the public purse. To put it another way, what is the likelihood that the revenues that a profitable public enterprise is contributing to the revenue of the government will dry up? Along the same lines, what is the likelihood that an unprofitable public enterprise will incur losses such that a bailout will be required? In assessing these risks, we cannot look just at the impact of an enterprise on the public purse currently. We have to be forward looking, which requires that the factors identified in the box, many of which are related to the commercial orientation of the enterprise, be considered. We have to look behind the numbers and look to such things as the governance structure of the enterprise and market structure.

To illustrate, consider Ecopetrol, which was also mentioned earlier in the discussion. Ecopetrol has been judged in the pilot to be an enterprise that is not commercially oriented, and there are significant fiscal risks associated with its operations. At the same time, many reforms are currently underway that will see the commercial orientation of Ecopetrol slowly increase. The key in this case will be to look at those particular reforms and to ascertain whether the commercial orientation of Ecopetrol has increased to such a degree that it does not pose a big fiscal risk.

On PPPs, on standardization of contracts, the unit in the United Kingdom responsible for the private finance initiative has been doing a lot of work on standardization and promoting standardization as a means of increasing transparency in the PPP process. The lack of progress so far on this issue has been a source of frustration for that unit. Ms. Jacklin may be right that, in terms of producing standardized contracts, we may not be able to make a lot of progress. At the same time, as the staff has mentioned, it does not mean that providing standard information about PPP contracts is impossible. The key terms and conditions of PPP contracts should be able to be presented in a common format. In fact, the Chilean government has produced a template for providing a summary of the concession contracts. The aim is to fill this template for all concessions, and to publish these on the web site of the government ministry responsible for the program.

Mr. Solheim made an important point on the issue of implicit contingent liabilities. Although it is clear that, where possible, implicit guarantees or implicit contingent liabilities should be made explicit, Mr. Solheim also made the point that, where the government does not stand behind a project or enterprise, it should be explicitly stated that there is no implicit guarantee. This comment will be reflected in the revised version of the paper.

Finally, Mr. Murray emphasized the importance of public sector comparators and their use in determining whether you should go ahead with PPP projects. The paper we presented on PPPs a year ago did not mention public sector comparators and should have done so. It was implicit but not explicit. As a result, possibly in the latest paper we are overcompensating, but it is an important point, which we fully recognize.

Mr. Misra considered that, as there was clearly a lot more work that needed to be done on these issues, including in the context of Article IV consultations.

The Acting Chair made the following summing up:

Executive Directors welcomed the opportunity to discuss the paper on lessons from the eight pilot country studies on public investment and fiscal policy, the accompanying paper summarizing the individual pilot country studies, and the study on government guarantees and fiscal risk. Directors commended the staff for the follow-up work applying the approaches discussed by the Board in 2004. They welcomed the additional insight provided about options for increasing infrastructure investment in a fiscally responsible manner, the coverage of fiscal indicators and targets, the treatment of public enterprise accounts, and issues related to the fiscal implications of public-private partnerships (PPPs). They appreciated the pilot studies' coverage of a diverse group of countries in Latin America, Africa, Asia, and the Middle East, but some Directors regretted the non-participation of advanced economies. Directors generally supported the conclusions derived by the staff from the studies.

Directors reiterated the importance of public infrastructure investment for economic growth, while acknowledging the lack of hard evidence in the pilot countries covered by the staff study on the precise relationship between the two, and emphasized the relative importance of complementary factors such as macroeconomic stability and the investment climate. Public infrastructure investment and rehabilitation needs remain sizable, especially in low-income countries. Directors noted the possible causes and consequences of the decline in public investment observed in several of the pilot countries, particularly its impact on growth. Possible causes may include fiscal consolidation, including in the context of Fund-supported programs; a fall in public saving; completion of major public infrastructure projects; shifting preference toward a smaller public sector; and development of a private sector able to handle a broader set of activities. Directors accordingly encouraged the staff to investigate further the effects on growth of the quality and composition of public expenditure, including public investment, and to improve debt sustainability analyses by taking account of available robust estimates of the growth implications of public investment. However, they emphasized that the World Bank should take the lead role in exploring the growth implications of specific public investment projects.

Directors supported the focus on the overall fiscal balance and on complementary indicators, such as the current fiscal balance, when assessing the scope for increasing public investment and the quality of a country's fiscal policy. They considered that the scope for increasing public investment by relaxing overall fiscal targets remains quite limited in most countries, particularly in those that have a high debt burden and are vulnerable to macroeconomic shocks. They stressed the overarching importance of ensuring that any borrowing to finance public investment is consistent with macroeconomic stability and debt sustainability. Where this outcome is not assured, Directors underlined that increases in public investment will need to be matched by increases in public saving through better prioritization of expenditure and, in many countries, sustained efforts to mobilize additional revenue. More policy options will be available to countries with relatively low debt burdens and to countries with access to concessional financing on a sustained basis. Directors also emphasized the need to improve the quality of new investment by strengthening the institutional capacity for project appraisal, selection, and implementation, which remain the responsibility of the multilateral development banks. In this regard, they saw an important role for technical assistance from the multilateral development banks.

Directors stressed that a key conclusion emerging from the studies is that additional room for public infrastructure spending cannot be created by changes in fiscal accounting. Countries with different levels of economic and institutional development could well have different "optimal" ratios of public investment to GDP. An assessment of the scope for increasing public investment in any given country will require, in particular, careful analysis of macroeconomic conditions; debt sustainability; the quality of the proposed projects; and the trade-offs among taxes, public infrastructure spending, and other types of expenditure. Directors also emphasized the need to address non-infrastructure bottlenecks to economic development, in particular the policy and institutional environment for private investment, including especially the tax and regulatory frameworks and governance.

Directors generally saw merit in the staff's call for comprehensive coverage of public enterprises in fiscal statistics, in line with the Government Finance Statistics Manual 2001 framework, to allow closer monitoring of their operations. They recognized, however, that due to data problems this will be a difficult task achievable only over time. Most Directors endorsed the approach proposed by the staff for moving forward in this area by progressively integrating public enterprise operations into countries' fiscal accounts, thereby ensuring greater uniformity of reporting across the membership over time. With regard to the treatment of public enterprises in fiscal indicators, Directors noted that hardly any public enterprise meets the criteria for commercial orientation proposed in the staff paper considered by the Board in April 2004. They, accordingly, broadly endorsed the proposed revised approach to the inclusion of public enterprises in fiscal indicators and targets, with its greater focus on the fiscal risks posed by the operations of public enterprises, rather than mainly on their commercial orientation. Most Directors also agreed that testing the revised criteria in a limited but representative sample of upcoming Article IV consultations could inform the design of a strategy for moving forward in a manner consistent with staff resource constraints. A few Directors felt that it would not be appropriate to allow for greater case-by-case flexibility in making decisions on integrating public enterprises in fiscal indicators and targets in a Fund-supported program context, and noted the difficulties of assessing fiscal risks posed by individual enterprises. These Directors called for the development of a more standardized approach.

Directors agreed that PPPs offer a potential avenue to increase infrastructure investment, provided they are appropriately structured, and the institutional framework is well developed. They agreed with the view that PPPs should be undertaken with the goal of increasing efficiency by attracting private capital to infrastructure investment, and strongly cautioned against pursuing PPPs because of a desire to move investment spending off budget. Furthermore, the government should assess carefully the risk associated with PPPs, and ensure that this risk is appropriately shared with the private sector, with the risk borne by the government reflected in the fiscal accounts. Directors endorsed the view that high priority should be given to strengthening the institutional framework for PPPs—including the establishment of a sound legal framework and the preparation of a public sector comparator—and called on the multilateral development banks to take the lead on these issues.

Directors saw the lack of an internationally accepted accounting and reporting standard for PPPs as a possible obstacle to the development of efficient PPPs. They endorsed continued staff work with the relevant accounting bodies to promote the preparation of such a standard in order to ensure full transparency of PPP operations, while acknowledging the considerable time-intensity and complexity that will be involved in this venture. In the meantime, Directors generally endorsed the proposed disclosure and reporting requirements for PPPs. In this connection, Directors noted the importance of valuing the contingent liabilities associated with guarantees. Regarding the incorporation of PPPs in debt sustainability analysis, most Directors saw merit in the proposed approach, which involves counting committed payments by the government under PPP contracts and expected payments arising from the calling of guarantees as future primary spending. A few Directors called for caution in factoring implicit contingent liabilities related to PPPs into debt sustainability analyses. Most Directors agreed that the issue of setting caps on expected costs arising from PPPs, including in Fund program design, should be determined on a case-by-case basis, with a focus on cases where these costs contribute, or limit the capacity to respond, to debt sustainability problems.

Directors noted the staff's assessment that further work along the lines being proposed may require significant additional staff resources, which will be quantifiable only over the longer term, depending on the pace at which national authorities can move to include public enterprises in the fiscal accounts, and the results of the testing in a sample of Article IV consultations of the revised criteria for assessing the fiscal risks posed by public enterprises. The issue of resource cost, as well as the balance of costs and benefits that emerges moving forward, will therefore need to be kept under close review.

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SHAILENDRA J. ANJARIA
Secretary