

On the recent trends in the field of public investments and medium term priorities

Background

1. Public investments represent an important economic development tool. The current efforts bent by all relevant government authorities are focused on ensuring the economic growth. The setting up of an enabling environment for sustainable economic growth depends to a large extent upon the infrastructure recovery and development. Hence, the upgrading of infrastructure is one of the key goals of the government’s policy in channeling public investments.
2. The given note consists of an overview summary of recent trends in public investments, sets the medium-term priorities for capital investment funding from the government budget and for the projects financed from external funds, as well as defines a number of measures to improve the management of public investments.
3. In the context of the given note, the definition of public investments means the capital investments that include the construction, expansion, reconstruction and provision with technical equipment of existing objects designed for various purposes, as well as the projects financed from external funds, included in the government budget.
4. For the purposes of this study, the sectors defined in the functional budget classification were grouped into five main areas, as follows: (i) *infrastructure*¹, (ii) *education, sciences/research, and innovations, culture, sports and youth-targeting activities*, (iii) *health care, social care and support*, (iv) *general government services and external activities*, and (v) *national defense, justice, and law authorities*.

I. Recent trends in the area of public investments (2002-2005)

5. Recent trends in public investment spending show a considerable growth of those in nominal value from MDL 649.2 million in 2002 up to about MDL 1318 million by 2005, doubling its share in the GDP from 3 per cent reported back in 2002 up to 4 per cent by 2005. Moreover, there was an increase in the share of investment costs in the overall public expenditure from 8 per cent in 2002 up to 9 per cent in 2005. These trends denote that investments have an increasing priority in the budget structure. Table 1 presents the evolution of public investments by sources of funding and it reflects their share in the GDP and in the overall public costs.

Table 1. Trends in public investments financed from various funds

| | 2002 | | 2003 | | 2004 | | 2005 | |
|--|--------------|------------|--------------|------------|--------------|------------|----------------|------------|
| | MDL million | (per cent) | MDL million | (per cent) | MDL million | (per cent) | MDL million | (per cent) |
| Government budget* (basic costs) | 21.5 | 3 | 99.3 | 14 | 114.3 | 12 | 284.4 | 22 |
| ATU budgets | 236.7 | 36 | 208.7 | 29 | 429.1 | 46 | 530.6 | 40 |
| Projects financed from external funds | 391.0 | 60 | 410.3 | 57 | 384.8 | 41 | 503.9 | 38 |
| Total investments (from any funds) | 649.2 | 100 | 718.3 | 100 | 928.2 | 100 | 1 318.9 | 100 |
| Share in the GDP | 22,556 | 3 | 27,619 | 3 | 31,992 | 3 | 36,800 | 4 |
| Share in the total public expenditure | 7,725.5 | 8.4 | 9,147.3 | 8 | 11,252.9 | 8 | 13,949.3 | 9 |

* -it reflects investments coming directly from the government budget, without the relevant transfers from the ATU budgets.

6. The analysis by sources of funding indicates a considerable growth in capital investments made from the government budget (without any transfers from the ATU budgets), signaling an increase from MDL 21.5 million up to MDL 284.4 million during 2002-2005 . A significant increase occurred in 2005 due to an increase in the government budget revenues. As proportion of overall investments, the government budget

¹ Infrastructure implies agriculture, forestry, fishery, water service; environment protection and hydrometeorology; industry and construction; transports, road services, communications and information; utilities and residential services, fuel and power industry.

share increased from 3 per cent reported in 2002 up to about 22 per cent in 2005. This implies the importance given to the capital investment funding during the last years.

7. At the same time, there is a significant contribution to the financing of public investments from external funds. On top of this, the share of these in the overall amount of investments dropped from about 60 per cent reported in 2002 down to circa 30 per cent in 2005.

8. Investments defrayed from the ATU budgets have also reported an upward sloping evolution, with an increase of about two times during 2002-2005. This growth is determined to a great extent by an increase of about nine times in the amount of transfers earmarked for the investments funded from the state budget, which accounted for circa 60 per cent of the amount of investments financed from the ATU budgets in 2005. During the same timeframe, the share of ATU budgets in total investments varied each year, remaining basically constant at the level of about 40 per cent.

9. The cross-sector analysis of public investments shows a considerable growth in 2002-2005 of about six times in the public investments earmarked for infrastructure, using up the biggest share in the overall investments. In 2005 a significant expenditures increase has been targeted for investments. About 56 per cent of total investments were earmarked for infrastructure in 2005. Table 2 is emphasizing the trends in the structure of investments by basic fields.

Table 2. Cross-sector structure of public investments throughout 2002-2005

| Sector | | 2002 | | 2003 | | 2004 | | 2005 | |
|--------------|---|--------------|--------------|--------------|--------------|--------------|--------------|---------------|--------------|
| | | MDL million | Per cent | MDL million | Per cent | MDL million | Per cent | MDL million | Per cent |
| Total | | 649.2 | 100.0 | 718.3 | 100.0 | 928.2 | 100.0 | 1318.9 | 100.0 |
| 1 | Infrastructure | 472.2 | 72.7 | 506.4 | 70.5 | 585.8 | 63.1 | 741.1 | 56.2 |
| 2 | Education, culture and science | 104.2 | 16.0 | 79.6 | 11.1 | 107.8 | 11.6 | 152.7 | 11.6 |
| 3 | Health care and social care and support | 59.2 | 9.1 | 57.5 | 8.0 | 146.9 | 15.8 | 154.9 | 11.7 |
| 4 | Government services and external activities | 11.1 | 1.7 | 70.7 | 9.8 | 72.7 | 7.8 | 224.4 | 17.0 |
| 5 | National defense and law authorities | 2.6 | 0.4 | 4.1 | 0.6 | 15.0 | 1.6 | 45.8 | 3.5 |

10. A more thorough review of infrastructure sectors indicates the following key trends:

- a) The share of capital investments in the fuel and energy industry increased from 1.1 per cent in 2002 up to approximately 40.3 per cent by 2005. The given increase is determined first of all by a growth in investment funding made available to centralized gas supply programs;
- b) Utility allocations have also considerably grown;
- c) One could notice a shortage in capital investment funding earmarked for transport, road services, communications, and information management. The funding for this sub-sector was only about MDL 17 million during 2002 – 2005; and
- d) Investments have been made in such fields as energy, heating, water supply, and roads, within the framework of investment projects, with involvement of external funds.

II. Medium-Term Forecasts and Policy Priorities (2007-2009)

General Objectives

11. Provided that public investments are the key factor in economic growth and the decisive ingredient in national economy development and restructuring, the medium-term government policy in the field of public investments will target the accomplishment of the following objectives:

- 1) Making investments that allow for the most profits and that ensure making the full use of material, human and financial resources;

- 2) Completion and full funding provided for the ongoing investment projects;
- 3) Channeling capital investments towards public infrastructure development, specifically the roads infrastructure, thus having a larger impact on economic growth and poverty reduction;
- 4) Making investments into those sectors that have a considerable impact on the development of national economy, as well as on those that ensure the operation of government structures and the support of their infrastructure; and
- 5) Securing the environmental protection.

Medium-Term Priorities

12. Making allowance for the recent trends in the growth of public investments spending, the government will have to carry on the efforts for boosting up public investments in the following years, specifically in areas where the private sector has no interest vested in investments. Moreover, there is need to develop alternative investment funding mechanisms of a public-private partnership type.

13. According to the government's Program of Actions for 2005-2010 "Upgrading the economy is upgrading the country", as well as in line with the EGPRSP provisions, infrastructure development will be one of the key priorities of the government in the area of public investments in the medium run. When setting priorities within infrastructure sectors, the emphasis will be put on those sectors that ought to result in more significant social and economic impact at the expense of other sectors. Hence, the priority sectors for investments are thought to be the roads and transport infrastructure, energy industry, and water and sewer supply, over the next three years. These areas are also deemed a priority in the context of Moldova's aspiration to get integrated with European structures.

i) Transport

14. In order to resuscitate and develop the transport and roads infrastructure, priority funding will be made available to roads reconstruction programs and those that reverse the decay of the roads infrastructure, as well as to those targeting the upgrading of the technical assessment of the roads. Taking into account the huge costs incurred when rehabilitating and keeping up the roads infrastructure, coupled with scarce resources available for this within the budget, there is need to involve the private sector, including foreign companies, for the reconstruction and management of national roads. On top of this, there will be negotiations with international entities on the opportunity of receiving grants or loans on privileged terms in view of rehabilitating the national roads of European importance.

ii) Energy

15. Securing the country's energy safety is one of the fundamental tasks of the government at this stage. The recent events revealed a burning issue in having to diversify the energy sources of all kinds. The increase in the prices for energy resources is having a direct adverse impact on the situation the population and companies alike are facing. The basic energy development issues are determined by the technical status and financial shortages at many energy-producing enterprises, as well as by the faulty organization of energy supply and consumption. Thus, the medium-term energy development objectives are to enhance the energy safety of the country and to set up opportunities for an efficient and sustainable development in this area.

iii) Running Water and Sewer Supply

16. Alongside other areas, the water supply and sewer infrastructure will also be a priority in the agenda. Priority in funding will be given to the works for reconstructing and upgrading of water supply systems, water purification and disposal of residual/waste waters, water conservation, and environment protection.

Medium-Term Forecasts

17. Having as a basis the constraint resources framework and the uncertainty regarding the foreign financing of certain investment projects, a very limited amount of reserves is estimated with the purpose of increasing capital expenditures for the period of 2007-2009. The amount of capital investments provided from the state Budget to the ATU budgets is estimated to MDL 640 mln annually for the medium term.
18. The forecasts for capital investment costs defrayed from the government budget in the medium run were prepared taking into account the above-said policy priorities and show a slow growth in the allocations earmarked for infrastructure development, as well as for the social fields and areas – education, culture, and health care. It is worth mentioning that the structure of resources allocation for sectoral investments will be able to reflect better infrastructure setoral priorities once with the completion of objects started in other lower priority sectors.
19. Table 3 is presenting the cross-sector structure of capital investments made from government budget for 2007-2009

Table 3. Cross-sector structure of capital investments made from government budget, 2007-2009

| | Areas | 2007 | | 2008 | | 2009 | |
|---|---|---------------------|--------------|---------------------|--------------|---------------------|--------------|
| | | Amount, MDL million | Per cent | Amount, MDL million | Per cent | Amount, MDL million | Per cent |
| | Total | 507.0 | 100.0 | 512.0 | 100.0 | 512.0 | 100.0 |
| 1 | Infrastructure | 231.1 | 45.6 | 234.9 | 45.9 | 239.1 | 46.7 |
| 2 | Education, culture and science/research | 138.7 | 27.4 | 140.5 | 27.4 | 141.0 | 27.5 |
| 3 | Health care and social support | 28.8 | 5.7 | 29.4 | 5.7 | 29.7 | 5.8 |
| 4 | Government services and external activities | 65.6 | 12.9 | 66.6 | 13.0 | 60.0 | 11.7 |
| 5 | National defense and judicial authorities | 42.8 | 8.4 | 40.6 | 7.9 | 42.1 | 8.2 |

20. From the total amount of capital investments defrayed from the government budget estimated for 2007-2009 earmarked for infrastructure, each infrastructure sector accounts for about one-third of that amount. As to the capital investments earmarked for education, culture and science/research, the education accounts for the biggest share with about 57 per cent, followed by culture with 32 per cent.
21. Table 4 presents the forecasts done for the project estimates financed from **external funds** for 2006-2009 and is revealing a considerable increase in the amount of expenditure from external funds in 2007, with a drop in this in 2008 and 2009. This could be explained by a quickening pace of implementation in 2007 for such projects, as “Improvement of water supply systems in six communities of Moldova”, Energy project and Investment Fund projects, as well as by the planning of wrapping up the water supply and sewer project. Besides this, the drop of allocations earmarked for 2007-2009 is determined to a great extent to the fact that not all external funding sources for the projects during the above set timeframe have been defined to date.

Table 4. Cross-sector structure of investments financed from external funds, 2006-2009

| | Area | 2006 | | 2007 | | 2008 | | 2009 | |
|---|---|--------------|--------------|--------------|--------------|--------------|--------------|-------------|----------|
| | | MDL million | Per cent | MDL million | Per cent | MDL million | Per cent | MDL million | Per cent |
| | Total | 711.4 | 100.0 | 831.5 | 100.0 | 504.4 | 100.0 | 254.7 | 100.0 |
| 1 | Infrastructure | 402.8 | 56.6 | 590.8 | 71.1 | 357.1 | 70.8 | 215.5 | 84.6 |
| 2 | Education, culture and science/research | 37.8 | 5.3 | 51.6 | 6.2 | 58.5 | 11.6 | 21.7 | 8.5 |
| 3 | Health care and social support | 218.4 | 30.7 | 115.8 | 13.9 | 43.4 | 8.6 | 0.0 | 0.0 |
| 4 | Government services and external activities | 52.4 | 7.4 | 73.3 | 8.8 | 45.4 | 9.0 | 17.5 | 6.9 |
| 5 | National defense and judicial authorities | 0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

- 22 It is estimated that additional revenues that will be received in the state and ATU Budget in the period of 2007-2009 be targeted for increasing the capital investments, financed by the budget
- 23 More detailed forecasts for capital investment costs by sectors are presented in Annex 9, outlining the ceilings for the expenditure defrayed from the government budget by sectors.

III. Management of Public Investments

- 24 Making allowance for the burning shortage of investments to ensure a sustainable economic growth, as well as taking into account the scarce public financial resources available, the improvement in the management of resources for public investments is the key prerequisite for raising the level and increasing the efficiency of public spending earmarked for investments.
- 25 With the support of the Department for International Development, an in-depth analysis was conducted in 2005 on the existing procedures for the planning and management of investment projects. Despite some efforts having been bent over the last years aiming at improving the management of investments, specifically in terms of the way the investment budget is presented, and the shrinking list of started projects, the analysis brought out a number of shortcomings and flaws, in particular: (i) launching of new projects at the expense of the ongoing ones, and way too many small-size investments; (ii) insufficient strategic focusing on investments; (iii) lack of strict criteria and mechanisms for investment prioritization, thus implying a political dimension in selected projects; and (iv) missing clarity in the legal and institutional frameworks regulating investments.
- 26 Therefore, the management improvement implies the setting by the government of clear-cut priorities for public investments, improvement of decision-making mechanisms for the financing of projects, direct improvement of investment project management procedures, as well as the need to implement some institutional and legal reforms. The setting of ceilings for costs by sectors within the limits of overall resources and bringing the needs in line with budget resources available is a first step towards improving the financial discipline.
- 27 The following short-term and medium-term measures for the consolidation and improvement of public investment management are suggested to sort out the above-said challenges.

Short-Term Measures

- 28 The development of training materials / “Recipient’s Guidelines” / in order to improve the process of capital investments project preparation and implementation, including the professional qualifications of specialists in charge of those;
- 29 Development and testing of the investment-linked decision-making process, divided into two phases: preliminary perusal of projects, and project selection;
- 30 Financing of capital investments strictly by priorities, as identified and consistent with resource availability in the medium run; and
- 31 Further reduction in the number of new objects and the focusing of resources on the completion of the ongoing projects, the implementation costs of which being consistent to the ceilings set for resources in the medium run.

Medium-Term Measures

- 32 Improvement of the legal and norm-setting framework for the financing of capital investments from the government budget and from ATU budgets;

- 33 Implementation of regulations / legal acts that would formalize the project cycle, defining the phases of the cycle and setting up the institutional arrangements and procedures for project cycle regulation; and
- 34 Establishing a close link between the project cycle and the annual budget cycle, i.e. the decisions whether to finance or not ought to be made based on preliminary feasibility studies, making allowance for the project preparation and implementation phases.

Conclusions

- 35 Public spending on investments increased three times over the last years (2000-2005), with a large share and contribution from the government budget and from the ATU budgets.
- 36 In stark contrast to agriculture, fuel and energy industry, utilities, and residential housing, which used to have priority funding during the previous years, the transport and roads services were facing financial constraints.
- 37 In the medium run (2007–2009), public investments will be targeting the economic infrastructure as a priority, specifically aiming at the construction and renovation of roads, energy, and water supply and sewage systems.
- 38 The analysis identified burning issues with respect to the way the investment projects are planned and run. Radical steps ought to be taken in the coming years, aiming at improving the management of public investments, in the sorting out of which the government plays a decisive role and that has a direct impact upon the share of public spending earmarked for investments.