Capital Expenditures: Making Public Investment Work for Competitiveness and Inclusive Growth in Moldova

Authors: Karen Stephanie Coulibaly and Mame Fatou Diagne

A recent World Bank Public Expenditure Review for Moldova, conducted using BOOST, analyzes the inefficiencies in the allocation and implementation of capital expenditures. It provides recommendations for improving their effectiveness and to enhance Moldova’s competitiveness and achieve sustained inclusive economic growth.

Introduction

Like many countries in the world, Moldova faces the challenge of meeting considerable public investment needs while preserving fiscal sustainability. In recent years, Moldova has experienced rapid poverty reduction, and gains from growth were widely shared. Over the period 2006–12, the national poverty and extreme poverty rates fell from 30.2 and 4.5 percent to 16.6 and 0.6 percent, respectively, and over the period 2006–11, consumption of the bottom 40 percent grew by 5.7 percent. However, with a rapidly aging population, high emigration, structural imbalances, and vulnerability to external shocks, Moldova will need to raise investment, productivity, and exports in order to achieve sustained growth and competitiveness. While convergence with the European Union may anchor growth, infrastructure and investment climate upgrades are needed to fully capitalize on emerging opportunities.

At the same time, the prospects for raising overall revenues in Moldova are limited. Tax revenue is already high as a percentage of GDP (in comparison with other countries in the Europe and Central Asia [ECA] region), and declining external assistance could further reduce general government revenue and weigh on capital investment funding. A favorable public debt outlook but high private debt leaves room for modest borrowing to fund priority projects, provided that borrowing remains prudent and selective. Given these constraints, funding

KEY MESSAGES

- Despite experiencing rapid poverty reduction and inclusive economic growth over the past decade, Moldova needs to raise investment, productivity, and exports in order to achieve sustained growth and competitiveness in the long term.
- A recent World Bank analysis of public investment processes and outcomes using a diagnostic framework and a specially-developed BOOST capital expenditure module reveals significant inefficiencies in the allocation and implementation of Moldovan capital expenditures. This is largely due to inadequate project appraisal, spreading of resources over small, fragmented and insufficiently prioritized projects, and long implementation periods.
- Better public investment decisions can be achieved through the implementation of reforms focused on improving project appraisal mechanisms, improving budgeting processes, and strengthening project implementation monitoring systems.


2Support of the Europe and Central Asia (ECA) regional BOOST initiative, financed by trust funds from the Bank-Netherlands Partnership Program and the ECA Public Financial Management Multi-Donor Trust Fund, is gratefully acknowledged. Launched in 2010, the BOOST initiative is a Bank-wide effort to promote access to, and the effective use of, budget data for improved decision-making processes, transparency, and accountability. For more information: http://siteresource.worldbank.org/INTECA/Resources/K843onBOOST.pdf.
public investment objectives will require significant expenditure adjustment and rationalization.

The World Bank’s recently published Moldova Public Expenditure Review (PER) focuses on capital expenditures and recommends reforms in public investment management and sector policies to raise cost effectiveness and allocative efficiency. The PER draws on an analysis and review of the structure and classification of the capital budget, recent trends in capital expenditure levels and execution, and the adequacy of resource allocations and utilization across sectors (given investment needs, national priorities, and implementation capacity). It also incorporates a diagnostic of the strength of Moldova’s public investment management system. Analyses for the PER were conducted using the BOOST public expenditure database developed by the World Bank.

Using BOOST for Public Expenditure Analysis

BOOST is a country-specific database of disaggregated government expenditure data from a national treasury system. BOOST datasets can also be extended into sector-specific modules that link government spending with nonfinancial performance data (e.g., inputs, outputs, and outcome data).

The Moldova BOOST follows the national fiscal reporting methodology and includes information on the approved, revised, and actual budgets broken down by government level, administrative units, subnational spending units, economic and functional classification, and financing source. The Moldova capital expenditure module expands the (core) BOOST dataset to include information at the detailed object level and supplements it with performance information monitored by the Ministry of Finance.

In the Moldova PER, both the core BOOST database and the capital expenditure module were used to flag inconsistencies in budget classifications; analyze the trends, efficiency, and distributional equity of capital expenditure; and suggest improvements in government monitoring of public investment projects.

Flagging Inconsistencies in Budget Classifications

Comparing selected BOOST data economic, functional, and administrative breakdowns with special funds and sector-specific administrative data revealed inconsistencies in national budget classifications. Expenditures classified as “capital transfers” did not always correspond to expenditures for the purpose of acquiring capital. Specifically, after 2008, spending on road maintenance executed through the Road Fund was classified as “capital transfers within country” (Figure 1). These maintenance expenditures should have been recorded in the recurrent section of the budget as they had been prior to 2009. Correcting for this classification issue, capital spending as a share of GDP in Moldova would have been roughly 5 percent in 2012, rather than 6 percent.

Analyzing Allocative Efficiency

Moldova’s National Development Strategy for 2012–20 outlines seven priority areas for reform and development, including large public investments in national and local road infrastructure, water and sanitation infrastructure, energy efficiency, power generation capacity, and physical interconnections with neighboring countries in gas and electricity.

Figure 1. Road Fund Spending by Economic Classification, 2006–12

BOOST data facilitated simultaneous micro analyses of budgeted and actual spending trends. A comparison of these trends with Moldova’s development objectives established that budgeted spending trends were broadly consistent with strategic objectives, with the exception of the fuel and energy sector. Budget execution performance varied by sector, so that actual budget outlays were less aligned with national strategic priorities (Figure 2).

Figure 2. Changes in the Composition of Spending and Budget Execution Performance by Sector

\footnote{In Moldova, public expenditure is understood in terms of discreet “objects,” unlike the more restrictive notion of “projects” in international practice. Whereas a project refers to a planned set of interrelated tasks executed over a fixed period and within certain cost (and other) limitations, an object refers to any item for which a cost is compiled. An object can be a product (e.g., “9754 Bust of Emil Loteanu in the park of cinema ‘Patria,’ Municipality of Chisinau”), a service, a project (e.g., “9248 Project ‘Regional Development and Social Protection in the Republic of Moldova’”), or an activity (e.g., “9814 Construction of Primary School-Kindergarten in Commune Cotul Morii, District of Hincesti”). We will, however, refer to projects throughout this brief.}
The gap between budgeted and executed expenditures also suggested implementation issues (particularly in the transport and utilities sectors).

A closer look at the utilities sector illustrates this gap. The allocated budget approved by local governments for utilities increased over 2006–12, while the executed amounts declined (Figure 3). At the central level, budgeted and actual utilities expenditures moved in opposite directions. This may be due to delays in implementation of the Regional Development Fund and externally funded projects for water and sanitation, and is an example of how Moldova has been unable to fully utilize available external funding in a sector with considerable investment and repair requirements. This points to a need for improvements in the general public investment management system, enhancements in procurement and administrative skills within local agencies and utility companies, and resource pooling in order to strengthen implementation capacity.

Figure 3. Trends in Central and Local Government Capital Expenditures on Utilities

Analyzing Equity and Regional Distribution

While capital expenditure is not necessarily to be used for redistributive purposes, public investment can help reduce poverty and provide equal opportunities for all. There are large inequalities in access to public services, such as improved water and sanitation, education, and health, across Moldova. Investments in local roads are a prerequisite to equal access to these services. Furthermore, investment in agricultural production and resilience, as well as measures to enhance agricultural productivity and boost exports, can increase the incomes of the most vulnerable segments of the population.

Analysis using BOOST local capital expenditure data, census, and poverty data led to the conclusion that the geographic distribution of capital expenditures is broadly in line with the distribution of the population and perhaps redistributive goals, as per capita spending is higher in districts with higher poverty rates.

Analyzing Cost Efficiency

Analysis of capital projects using the BOOST capital expenditure module demonstrated that an “optimism bias” (a propensity to underestimate costs or overestimate benefits) is evident in local investment and is more widespread in the education and utilities sectors. In recent years, the estimated project cost at inception was exceeded in about a third of local investment projects, by 60 percent on average. There were cost overruns in 20 percent of local government capital repair projects, and these overruns averaged nearly 50 percent. At the central government level, the proportion of projects with cost overruns has also been increasing over time. In 2011, there were already overruns in three out of 12 projects initiated in 2010.

In parallel, resources are being spread more thinly on local investment projects. The capital budget is characterized by the proliferation of many small projects with low value, particularly at the local level. The average planned expenditure on local projects dropped from 13.5 million lei (Moldovan currency units) in 2001 to 1.7 million lei by 2009, and was as low as 222,000 lei in 2011 (Figure 4).

Figure 4. Average Investment Spending per Project (2001–11)

Furthermore, funding for ongoing projects is not continuous and is being spread out over longer implementation periods, especially at the local level. Since 2006, between 30 and 50 percent of executed expenditure was spent on new rather than ongoing projects, and consequently, budget allocation to ongoing projects is often interrupted. Budget allocations were interrupted for over a third of the investment projects and a fourth of local repair components for which there were multi-year budget allocations, a phenomenon that is, again, more marked at the local level. Also more evident at the local level is a longer implementation period for projects; central investment projects tend to stall for a year on average, while local investment (and repair) projects tend to stall for two years.
Evaluating Public Investment Management Processes

An assessment of Moldova’s current public investment management system reveals a lack of regulated project appraisal processes involving systematic analysis. There is no formal requirement to conduct feasibility studies involving analysis of a project’s economic viability, financial sustainability, and environmental and social impacts. There is also no formal appraisal stage in which the findings of feasibility studies are assessed and a decision made on whether or not a project represents good use for public money and thus qualifies to be submitted for funding.

Using the BOOST capital expenditure module, the distribution of new central and local investment projects by estimated total cost for each year between 2006 and 2011 was examined. Given the distribution of projects in Moldova, an initial threshold of 30 million lei was recommended for requiring full feasibility studies involving cost-benefit or cost-effectiveness analysis. This would mean that a small number (under 10) of fully domestically financed projects would be subject to a comprehensive cost-benefit analysis every year. Simpler approaches could be used for less significant investments, such that the sophistication of the appraisal method is proportional to the scale and complexity of the project and to the availability of skills within dedicated agencies.

The Path Ahead

In order to address the inefficiencies in the allocation and implementation of capital expenditures identified in the analysis, three key areas of reform are recommended: (i) raise the quality of new projects by improving preliminary screening and project appraisal mechanisms; (ii) improve the selection of new projects and ensure continuity of funding for ongoing projects through better prioritization and budgeting processes; and (iii) strengthen the monitoring of project implementation for cost efficiency and timely delivery of public services. A regulation adopted by the Government of Moldova in December 2013 established a framework to reform public investment management. Still, the agenda for improving the efficiency and equity of public investments in Moldova remains large. In addition to implementing the newly adopted regulatory framework, further improvements in monitoring could inform future adjustments to policy. In the short term, the monitoring of capital expenditure could be enhanced by adding up-to-date information on projects (e.g., total estimated cost and estimated completion date). This data would not only lead to better analytical outcomes, but would also yield better management of total project costs and earlier identification of implementation problems.

In most countries, fostering demand for better management processes, including greater transparency and more responsive monitoring systems, may help motivate governments to perform and sustain a results-oriented focus. In Moldova, BOOST has successfully led the way for more related initiatives to follow, including the open data initiative Budget Stories, which helps inform citizens on raw budget and execution data. Such tools can help improve transparency and create greater accountability for public expenditures.

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