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The Way Forward

So what does this framework mean for action in East Asian infrastructure? How does this framework point to challenges in the road ahead and give guidance toward solutions?

The framework set out in this study is analytical. It suggests a way of approaching problems, but is not a "tool kit" for implementing particular policies. Nonetheless, the framework has important policy implications. Here we trace 12 of them. They reflect key concerns articulated in the consultations undertaken in preparing this report, with the region's policy makers, policy implementers, infrastructure service providers, civil society organizations, and other stakeholders.

The 12 policy messages constitute an approach to strengthening infrastructure's contribution to inclusive development, as set out in Chapter 2. They promote the role of infrastructure in underpinning growth and poverty reduction. Infrastructure does not lead to inclusive development on its own—it requires actions that support the delivery of services to the poor who need them, and that underpin the growth dynamics on which improvements in welfare depend (Box 5.1). What do we need to think about to achieve this?

The discussion of coordination in Chapter 3 provides the basis for three of the policy messages arising from the framework. In Chapter 3, we saw how strategic vision has proved crucial for ensuring the effectiveness of infrastructure interventions. We also looked at a number of the challenges that arise in formulating and implementing this vision—coordination across financing and planning institutions, coordination across infrastructure and fiscal institutions, and coordination across

Box 5.1 Managing the contribution of infrastructure to inclusive development

While infrastructure is important, on its own it is not enough. Infrastructure has to work with other policies and interventions that also have an impact on inclusive development—on investment, innovation, or policy stability that affect growth; on those factors that affect people's ability to access services.

The impact of infrastructure on inclusive development also depends on a range of choices that countries have to make, and balances that they have to strike. Sharing of the benefits of infrastructure is not automatic. Broad-based impacts on poverty may be positive, but the local impacts can sometimes be negative, unless deliberately mitigated. There are genuine choices to be made between investments that will have a greater impact on poverty and those that will have a greater impact on growth—on rural roads, for instance, as opposed to port logistics. There are trade-offs to be made between the interests of the poor and the nonpoor.

How infrastructure contributes to inclusive development will vary by the nature of each country's growth and poverty challenges. In Lao PDR, it may be through greater links with the region. In Thailand, it may be through the creation of high-transaction business environments with easy accessibility. We know that infrastructure does have an impact on poverty, but precisely what investments are needed depends on whether a country faces mass poverty, or whether poverty is location specific; whether isolation is a root cause of poverty, or whether other factors such as caste, race, or a history of discrimination are more important.

decentralized government. The analysis set out in Chapter 3 gives us the following three policy messages:

1. The center matters—infrastructure demands strong planning and coordination functions

Infrastructure provides basic services on which survival and livelihoods depend; infrastructure is the backbone of economies and societies; infrastructure has major environmental impacts; infrastructure can bring powerful monopolies and foreign participation into areas of great sensitivity. As such, infrastructure is intensely political.

But infrastructure is also economically and technically complex, and has long-term implications. So the technocrats, too, have a critical role to play as they complement the role of politicians. This extraordinary blend of technocracy and politics places a premium on high-level, central institutions, which can articulate strategies that are politically sustainable and economically effective.

Institutions that can formulate those long-term strategies, and can coordinate the policies of different agencies to implement them, are essential to effective infrastructure service provision. Objectives that move beyond the purely economic, to mainstream environmental and social considerations, demand higher levels of coordinating capacity than hitherto. Sector ministries and local governments cannot work in policy-making isolation.

Old top-down models of detailed economic planning should be eschewed, but new models of strategic planning and central coordination need to evolve. This should underpin tendencies toward democratization, decentralization, independent regulation, private participation, and the commercialization of service providers.

2. Decentralization is important, but raises a host of coordination challenges

There has been substantial decentralization of government in East Asia, and this has often increased the responsiveness of infrastructure service provision to local needs. Decentralization has undoubtedly played an essential political role.

However, decentralization poses a number of coordination challenges, both vertically (between central and local governments) and horizontally (among various subnational institutions).

Decentralized governments have sometimes been isolated within their own jurisdiction. This is problematic because most network infrastructure has interjurisdictional backbones. Isolation can mean secondary or tertiary infrastructure lacks connections to primary infrastructure—in a sense, it goes nowhere. Some municipalities may be too small to achieve the scale necessary to deliver infrastructure efficiently. In competing with each other, municipalities may duplicate expensive infrastructure facilities, when such facilities, in fact, could have been shared. Avoiding these pitfalls depends critically on interjurisdictional cooperation—on filling in the missing middle.

Higher tiers of government need to encourage lower tiers to collaborate where primary infrastructure requires such collaboration. Matching grants to induce decentralized governments to participate in such investments, and institutional mechanisms to encourage cooperation in infrastructure planning will play a major role.

Central governments also have to ensure that they maintain sufficient capacity to monitor, manage, and coordinate in a manner that is in line

with policy and regulatory frameworks. The inadequacy of such systems is a frequent cause of suboptimal service delivery and confused authority.

3. Fiscal space for infrastructure is critical

Ultimately, all infrastructure is paid for by users through tariffs or taxpayers through subsidies. Covering costs through user charges is a critical long-term objective. In the short term, user charges might be legitimately constrained by a variety of factors (see below under "subsidies") or large investment needs might require upfront financing to be recovered gradually from user charges.

Sometimes those financial shortfalls can be filled by the private sector, but sometimes private financing will be insufficient, unavailable, or unacceptably expensive. Even where the private sector comes in, it often requires risk-sharing with the public sector. In cases in which the private sector cannot or will not provide all the financing or bear all the risk, investments with adequate economic rates of return should be allocated fiscal space.[1]

Adequacy will depend in part on competing claims from noninfrastructure expenditures and from the need to keep fiscal deficits low. It will also depend on the veracity of the claim that user charges or private financing cannot fill the gap; sometimes it requires fiscal tightening to induce sector agencies to make reforms and seek other sources of funds.

In some East Asian countries, expenditure on infrastructure appears to have been less than optimal in recent years. Cambodia, Indonesia, Lao PDR, the Philippines, and Thailand could be candidates for this list of countries. This may have undermined economic growth and poverty reduction, and even long-run fiscal solvency.

This does not mean that more fiscal space for infrastructure should be the first step in those countries. In several cases, fiscal tightening for macroeconomic stability and debt sustainability would take higher priority. In most cases, the possibility exists for stronger promotion of private financing in infrastructure and for higher user charges. And there can be opportunities for cost reductions, or better management and maintenance of existing assets. In some cases, strengthening public expenditure management should come before more public expenditure. If adequate institutions and controls are not in place, countries can easily veer from underspending to overspending.

But if and when those difficult preconditions are met, governments should allocate fiscal space based on long-run growth objectives and in

pursuit of fiscal solvency. Infrastructure spending on worthwhile projects can create a virtuous circle: more growth, more fiscal revenue, more fiscal space. The challenge is to select the right projects—and put in place the policy and institutional frameworks that actually make them worthwhile.

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Our discussion of accountability and risk management in Chapter 4 provides the basis for five additional policy messages. In this chapter, we looked at a number of mechanisms through which accountability in infrastructure service provision can be strengthened—through the community, through regulation, and through competition—and how accountability and risk management arrangements can play out when governments provide support to infrastructure providers. The analysis set out in this chapter supports the following five policy messages:

4. "Subsidy" is not a dirty word—subsidies can be important, but are always risky, and should be handled with care

Infrastructure subsidies can be justified on a number of grounds, including environmental protection and poverty reduction. Although they would enjoy the environmental benefits, people often won't pay the full cost of sanitation, mass rapid transit, or renewable energy. In cases in which those benefits are external to consumers, subsidies may be needed to realize the benefits. Clean water or rural roads may have an important impact on poverty, but they may not be affordable by the poor. Such projects may require subsidies. And reform programs that help the poor or the environment may not be politically sustainable without subsidies for those with the power to derail the reforms. Similarly, transitional subsidies sometimes may be worth considering during short periods of economic crisis.

But subsidies can become open-ended and addictive, their fiscal impact can explode, they can undermine financial discipline and blur accountability, and they can postpone much-needed reform. Subsidies need to be employed with great care.

Subsidies should be a last resort after costs have been minimized through competition, regulation, appropriate technology and service standards, or public enterprise reform. Subsidies can be minimized through transparency, making them contingent on performance, or through subsidy bidding processes.

5. Competition is hard to achieve in infrastructure, but it's the best way to bring accountability

Infrastructure is quite often a natural monopoly, but institutional and technological innovation are expanding the potential for competition. It is now feasible to provide most infrastructure services (if not always the infrastructure itself) competitively. The most direct, and hence most effective, way of holding service providers accountable is through competition.

East Asia has been cautious about the introduction of infrastructure service competition; it has often preferred to "throw" more infrastructure at a problem rather than provide incentives for more efficient infrastructure services or address the political economy obstacles to competition.

This approach may have been effective when the basic infrastructure was being built, when economic objectives were relatively simple, and when top-down command solutions prevailed. But, as complexity increases, those approaches can be expected to work less well, and the role of competition will need to increase.

6. Regulatory independence matters more in the long run than in the short run

When competition is not yet firmly in place, regulation of monopolies will be needed. Regulatory independence from politics is an important long-term goal to ensure that service providers can cover costs and earn an adequate return on investments. However, regulators can establish their credibility with consumers, politicians, and investors only gradually. If regulators exercise more discretion than the political culture can absorb, a backlash can occur, creating unpredictability and instability.

Regulatory independence is a relative concept, and independence should grow step-by-step. New regulators should rely more on transparent rules than on discretionary power, and some responsibilities should be delegated to outside experts until in-house capacity can be built. Credibility, and hence independence, can be enhanced by transparency: Hearings should be public, as should contracts and licenses whenever possible. Accountability for regulators is key to their independence.

7. Civil society has a key role to play in ensuring accountability in service provision

Local communities within civil society can often manage local projects. They can participate in decision making about the large infrastructure

networks that touch their community, or those aspects of large projects that affect them directly. They may need special protection, as long as the larger needs of society don't get lost.

Civil society can play an important role in accountability of infrastructure institutions through parliaments or through consumer participation in regulation. Civil society organizations and NGOs can provide small-scale infrastructure services, act as watchdogs against corruption and vested interest, and play an advocacy role for more sustainable infrastructure policies and services.

Advocacy NGOs face difficult choices between representing the interests of specific groups or issues and representing the interests of society at large. How effectively and accountably they make those choices can have a significant impact on development outcomes.

8. Infrastructure has to clean up its act—addressing corruption is a priority

Infrastructure is often provided by monopolies, and can generate large rents. It often provides vital services, which are highly prized and highly political. As a result, financial discipline can be weak, political intervention intense, and rent-seeking prevalent. And the benefits of infrastructure can be easy to claim and hard to verify.

This combination of circumstances can create fertile ground for corruption. But that corruption discredits the very infrastructure on which it preys. This can undermine the political sustainability of infrastructure development, and deter those investors and financiers concerned about reputational risk and other costs of corruption.

Combating corruption is a long, hard struggle requiring strong top-down political commitment. Major reforms of the judiciary and civil service lie at the heart of any anticorruption effort. While these longer-term reforms are being put in place, significant progress can be made by removing rent-seeking opportunities and exposing transactions to public scrutiny.

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Four additional policy messages derive from analysis developed across this study, although they all take their departure from what we described as the "funding story" in Chapter 1. Here we saw that infrastructure can only be *funded* from two sources: the resources of consumers, and the resources of taxpayers. But infrastructure can be

financed by two other actors: the private sector (which may also include service providers), and official lenders and donors. The policy messages are as follows:

9. The private sector will come back—if the right policies evolve

Private investment in East Asian infrastructure peaked in 1997 and declined dramatically thereafter. It is now showing modest signs of recovery, but it still has not come close to matching the levels initially expected in the mid-1990s.

A perceptions survey was carried out for this study among 50 private companies active or interested in East Asian infrastructure investment. One survey response stood out above all others: A majority of investors said they were keen to invest, and would do so if policies were more predictable.

The private sector certainly has not disappeared from East Asian infrastructure; however, it is not actually making large investments. More predictable policies would bring it back. Moreover, if it came back, better regulation or more competitive market structures would help ensure efficiency gains from its return.

10. Public sector reform matters, but be realistic

In some places, the private sector won't come in sufficient scale, or will only do so on terms that are politically unacceptable (at least to specific groups with strong voice). This is likely to be particularly relevant in countries with small markets (population or purchasing power), those which are emerging from conflict, those where ideological opposition to private or foreign investment is particularly strong, or those where adjustment of large state-owned infrastructure is politically difficult because of employment effects. In some sectors, natural monopoly remains strong, so competition to induce the efficiency gains from private participation is not yet possible.

In sectoral terms, water and sanitation, large-scale hydropower and electricity transmission, some types of transport, and rural or cross-border infrastructure seem to have the hardest time attracting private investment, or using it to promote efficiency (although there are notable exceptions). In those situations, reform of the public sector may sometimes be the most feasible option for efficiency gains, at least in the near term.

But public sector reform is difficult to achieve, and even harder to sustain, so expectations should be modest. If the private sector can't be attracted because the state is unpredictable and lacks vision, or because tariffs and subsidies are below costs, then public sector performance is likely to be disappointing as well. Even if costs are covered, public resources may be better used in sectors other than infrastructure. The alternative of more thorough reform in the medium term to attract private investment should always be considered.

11. Local capital markets matter, but are not a panacea

East Asia's success is built, in part, on channeling high savings into domestic investment in infrastructure. The 1997 crisis underlined that domestic savings tend to be less footloose than foreign savings, and that domestic currency financing is less exposed to foreign currency risk. As domestic savings become more scarce, their efficient allocation becomes more necessary. As government functions become more complex, the delegation of resource allocation and risk assessment becomes more important. For these reasons, the contribution of the domestic financial sector to infrastructure development needs to grow.

Government will play an important role in regulating the domestic financial sector and encouraging financial innovation, as well as in promoting regional capital market initiatives. In countries where the policy—or quasi-fiscal role—of the financial sector has led to high levels of nonperforming loans to infrastructure, commercialization of the sector will be a priority in the near term. This will restore health to the financial sector and financial discipline to the infrastructure sector.

But to promote the financial sector's contribution most effectively over the long term, policies to improve the investment climate for infrastructure should take the highest priority. Trying to make a poorly designed infrastructure project work through financial engineering can have only limited effect; making it into a viable project through reform beyond the financial sector will usually have a greater impact.

12. Infrastructure needs reliable and responsive development partners

The development community is now reasserting its role in infrastructure in East Asia. But infrastructure is a long-term asset, and development partners need to stay for the long haul. Reliable partnerships—with quick

response and harmonized procedures—are critical. Moreover, the nature of this partnership (financing, guarantees, policy advice, capacity building, and so on) will have to be tailored to country conditions. The needs of East Asia's large, middle-income countries are different from the smaller and poorer countries in the region.

Official development assistance (ODA) accounts for approximately 1 percent of gross investment in low- and middle-income countries of East Asia. However, aid financing plays a more significant role in the poorer countries of the region, accounting for more than half of gross investment in Mongolia and Cambodia. Aid flows also play a significant role in most Pacific island countries, Timor-Leste, Papua New Guinea, and Lao PDR. The level of aid, and how it is allocated (including the share for infrastructure), plays a big role in the public spending and investment priorities of these countries.

The case for official financing depends on how well it can be used, the availability of other sources of financing, and the overall debt position of the government. The level of aid usually declines, and the blend of loans and grants usually becomes harder, as income levels rise in recipient countries. However, even higher-income countries may see benefits in tapping official financing to ease the debt burden on their budget and to catalyze private sources of funds. The technical assistance embedded in aid-financed projects—for project preparation, environmental and social assessments, and procurement practices—can be beneficial for shaping the government's overall policies and procedures.

During the 1990s, some key development partners in East Asia focused their efforts away from infrastructure, at least from infrastructure on a large scale. These partners felt that poverty reduction should be more targeted or that the private sector should step in to finance infrastructure projects. This tendency was intensified by the 1997 financial crisis, as the creditworthiness of affected countries and many infrastructure service providers declined. Aid financing in crisis-affected countries shifted to program support, as budgets were cut and new investments in infrastructure were sharply curtailed.

The role of official financing for infrastructure is now being reappraised. It is acknowledged that growth is crucial to poverty reduction, that targeting complements growth, and that infrastructure is essential for both. The private sector did step in, then partly stepped out, and may now step in again. But even at its peak, the private sector was a relatively minor player in financing terms, especially in the poorer

countries of the region, and official financing could be helpful to catalyze private investment. Some countries are now emerging from fiscal compression and need official financing to catalyze the private sector and provide more fiscal space for infrastructure spending. Support for more complex projects and new approaches can be particularly valuable.

As official financing for infrastructure increases again, it's important that it is used in a way that maximizes development impact. In the past, infrastructure projects have not always been well linked to a country's overall development and poverty reduction strategy. Aid must be used to support (rather than undermine) good policies. In some cases, this may mean funding sectoral programs, including recurrent spending for operations and maintenance and even subsidies. The broader impact of large-scale projects on government revenues must also be taken into account (as seen in the case of the Nam Theun 2 dam project, Chapter 4, Box 4.6).

Some official lenders and donors can provide instruments to back up government commitments to the private sector at a time when credibility with the private sector is still being established (for example, guarantees, insurance, official lending to the private sector). The overall case for the use of those instruments depends on a number of factors: first, the economic justification for the project; second, the proper allocation of risks among stakeholders and the ability to structure the guarantee to strengthen rather than dilute operators' incentives to deliver; and third, a robust budget framework for managing any contingent liabilities arising from government commitments.

However, in no case should such instruments be substitutes for good policies. Sound policies can reduce risks and demonstrate the government's commitment to reform. They are therefore more valuable to investors than official agency support per se.

Finally, official lenders and donors can provide important knowledge about what works and what doesn't in different countries and sectors. Some of this knowledge comes from higher-income countries that have been there before and learned from their mistakes and successes. It's therefore important that countries like Singapore and Korea stay engaged with the broader development community.

The type of knowledge needed will also vary by country—from basic institution and capacity building in poorer countries to more sophisticated market instruments in middle-income countries. For the latter, innovative ways are needed to combine private and public financing to extend

maturities for long gestation projects. New approaches to developing financing mechanisms at subsovereign levels also need special attention.

Spotlight 4. The way forward in Indonesia and the Philippines

Indonesia

Indonesia is emerging from a period of fiscal consolidation and political turmoil with a renewed commitment to addressing a number of delayed development priorities. Infrastructure has been identified as one of these priorities. The framework developed in this report provides important insights into the nature of Indonesia's infrastructure challenge.

Poor infrastructure outcomes are undermining inclusive development both through poor service delivery and growth impacts. Infrastructure in Indonesia has been neglected in the aftermath of the 1997 crisis and the impact on economic growth and people's well-being is apparent. Indonesia's current GDP growth—which levels off at around 4 percent—is limited by insufficient infrastructure investments. Several business climate surveys identify poor infrastructure as a key bottleneck.

Examples of direct negative impacts on poverty abound: Poor, or non-existent sewerage systems and solid waste facilities, for instance, have caused widespread contamination of surface and groundwater and lies behind the fact that Indonesia has the highest incidence of typhoid in East Asia.

Increased participation and rapid decentralization have given rise to a host of coordination challenges. Coordination between central and local authorities has suffered, as decision-making authority has been delegated but financial resources have not. Instruments to ensure that national priorities are reflected at the local level—such as matching grants for example—remain to be developed. Additionally, the provincial level of government remains underdeveloped, and as a result, local jurisdictions have often failed to coordinate, to take externalities into account, or take advantage of economies of scales.

Insufficient accountability is arguably the most critical problem affecting infrastructure in Indonesia. Transparency International Corruption Perceptions Index 2004[2] has ranked Indonesia 133rd out of 145 countries and perceptions of corruption remain pervasive in infrastructure

(Transparency International 2004). Opportunities for corruption arise at all stages of the infrastructure project cycle and a significant amount of public funds are being lost through corrupt practices.

New regulations on public procurement represent a clear improvement over previous policies, but serious weaknesses remain: for example, regulations leave room for excessive discretion in the selection of bidders; they fail to establish clear procedures to handle complaints from aggrieved bidders; and they do not apply mandatory sanctions to guilty parties.

Risk-sharing arrangements are at the heart of the government's infrastructure policy. Measures are urgently needed on several fronts. At present, the cost of infrastructure is being borne to a large extent by taxpayers. For instance, various fuel subsidies account for nearly 2 percent of GDP, and over two-thirds of water utilities operate with losses, because of inefficient operations as well as low tariffs. This distorts consumption and investment, and imposes fiscal strains, as consumers do not face the real costs of the infrastructure services they consume.

Risk allocation between public and private actors is also cause for concern. As the government seeks to restore private infrastructure investments, it is coming under pressure to offer guarantees to private investors in virtually all infrastructure sectors. A robust framework is urgently needed to help the authorities decide when public support should be provided and when it should not.

Within 100 days of coming to power, the new government held a successful "Infrastructure Summit" to develop a consensus between public and private actors on how to meet the challenges set out above. The Jakarta Declaration, issued at the end of the Summit, affirms the government's confidence that the challenges can be met, and outlines an agenda very much in keeping with the operational priorities laid out in the present chapter.

The summit highlighted the importance of infrastructure for growth and poverty alleviation. Increasing infrastructure spending while maintaining macroeconomic stability is identified as a priority. Indonesia is fortunate that the budget adjustment implemented by the government over the past five years has restored fiscal discipline and opened the possibility of additional public spending on infrastructure.

However, fiscal policy needs to remain prudent, which puts a premium on improving revenue mobilization over the medium term. And prudent fiscal policy will need to be matched with prudent financial

policy—which allows sound projects to be financed but does not lead to pressure for state banks to lend indiscriminately in the name of infrastructure.

The difficult coordination issues raised by the decentralization process need to be tackled. Greater clarity in the responsibilities and resources of different levels of government; financial instruments that would strengthen local authorities' incentives to take national priorities into account; a stronger provincial role to ensure better coordination among local jurisdictions; and effective capacity building at the local level would go a long way to improving the institutional framework for infrastructure development.

Increasing accountability has been identified as a central objective. One of the ways in which government is pursuing this is through regulatory reform. The government is committed to turning the embryonic telecommunications agency into a competent entity, and to implement recently adopted laws that call for the creation of regulatory agencies in the electricity and in the oil and natural gas sectors. In addition, regulations are being prepared to ensure the transparent and competitive selection of private partners for infrastructure projects. Additional measures on information disclosure and the imposition of tough sanctions on those convicted of corruption would further strengthen the framework for accountability.

The allocation of risks between taxpayers and users, and between public and private actors needs to be reviewed. Gradual tariff increases (accompanied by measures to increase operational efficiency) are required, especially in the water sector. Subsidies, such as those on gasoline and on automotive diesel oil, will need to be progressively eliminated in order to convey more precise price signals to users.

The government has started to review the framework for public support to private infrastructure projects. Its objective is to put in place the tools and processes required to better identify the projects warranting public support, to design such support in a way that strengthens operators' incentives to deliver, and to adequately evaluate and manage the liabilities that the government incurs in providing such support.

Finally, development agencies have been invited to help. The government has signaled that it would welcome investments geared at eliminating key infrastructure bottlenecks, as well as support in improving the conditions for private participation in infrastructure. An international workshop was held in 2004 to sound investors on their assessment of

opportunities in the power sector, and work has started on evaluating what needs to be done to clarify when and how public support will be extended to private infrastructure projects. In terms of instruments, the government would welcome financial and technical support in the implementation of sector-wide reforms, development interventions targeted at provincial and local authorities, and uses of development agencies' funds in ways that maximize catalytic impact with private investors.

The Philippines

While the Philippines performs better than Indonesia on key infrastructure access indicators (see Table 1.4), the impact of infrastructure on poverty, through growth and service access is still problematic. Levels of expenditure on infrastructure are low, at 2.8 percent of GDP—well below the estimate of 3.8 percent[3] of GDP required for middle-income developing countries to meet infrastructure needs (see Figure 1.10).

Strains are clearly showing. Performance in some areas, such as access to clean water, has deteriorated in recent years. There is also evidence to suggest that insufficient investments in infrastructure is partly responsible for relatively weak GDP growth: preliminary studies indicate a causal relationship from infrastructure to GDP in the Philippines, and that growth of the infrastructure capital stock has a positive and long-term impact on the level of GDP (World Bank, forthcoming b).

Challenges of coordination are one important part of this outcome. As we saw in Chapter 3, centralized infrastructure planning in the Philippines has been significantly weakened in recent years. Public infrastructure spending has been largely reactive, with short periods of high spending followed by longer periods of insufficient investments.

Infrastructure delivered at the subnational level has been neglected in the wake of decentralization, both because subnational plans have few champions at the central level, and because revenues do not match devolved responsibilities at the provincial level. This has resulted in underinvestment in particular in facilities such as solid and toxic waste disposal, in transport, and wastewater and watershed management. Local government units too have failed to rise to the challenge of local infrastructure provision as technical capacity and financial resource constraints have been pervasive.

Accountability presents similar challenges in the Philippines as in Indonesia, with a Transparency International Corruption Perceptions

Index ranking of 103 out of 145 countries (Transparency International 2004). Insufficient competition and regulation prone to capture by special interests create significant opportunities for graft. And, as set out in Box 3.4, discretionary "pork barrel" funds allocated to individual legislators are spent with little oversight and are major contributors to inefficiency.

Risk-sharing between taxpayers and users is affected, as in Indonesia, by the fact that tariffs, across infrastructure sectors, are insufficient to cover costs. The situation is particularly difficult in the water and sanitation sector, where tariffs are barely sufficient to cover operation and maintenance costs and certainly do not provide for rehabilitation or extension work.

Allocation of risks between public and private parties in infrastructure projects has also tended to be suboptimal. In the power sector, for instance, the government offered attractive power purchase agreements to private developers to try and eliminate severe power shortages in the early 1990s. As a result, excessive private investments in generation have burdened the sector with substantial stranded costs.

As in Indonesia, measures are needed on each one of these four fronts. Allocation of resources to infrastructure is an urgent priority. But the Philippine fiscal position differs markedly from that of Indonesia, with significant constraints on any further public investment. Under these circumstances, the country has little choice but to take gradual steps in increasing user charges. Meaningful tariff increases have already been implemented in the power sector.

Actions on tariffs need to be coupled with measures aimed at cutting costs and increasing efficiency. Here, the most promising course of action for the Philippines is to progressively open the provision of infrastructure services to competition. An ambitious liberalization program is in preparation in the power sector. A pro-competition strategy has also been at least partially implemented already in the telecommunications sector.

Improvement of coordination capacity requires strengthening of the central agencies with responsibility for infrastructure. Support of inter-jurisdictional cooperation arises as a further priority. Central agencies can help by strengthening linkages among national, regional, provincial and municipal planning. Finally, an adequate incentive framework needs to be developed to reward local government performance. This needs to be combined with the provision of assistance to local governments, both

with respect to strategic planning and with respect to project selection, preparation, and implementation.

Measures to address poor accountability have already been undertaken. The establishment of the Office of the Ombudsman, passage of the Government Procurement Reform Act of 2003, and involvement of civil society organizations as observers in bidding processes are encouraging developments. In addition, successful experiences with community-driven development have increased the transparency of infrastructure service provisions in specific cases.

But these efforts need to be sustained. This requires, for instance, vigorous implementation of the Government Procurement Reform Act, complemented by financial management reforms, and strengthening of the monitoring and enforcement capabilities of key anticorruption oversight agencies, such as the Office of the Ombudsman. Enhancing competition, and more effective regulation, will equally help foster accountability.

As far as risk sharing is concerned, the prescriptions for the Philippines are similar to those applicable to Indonesia. Tariff increases need to be implemented in a progressive manner, particularly in the water and sanitation sector, and the framework for provision of public support to private infrastructure projects needs to be strengthened. As in Indonesia, the government is well aware of such priorities and work is starting on a review of the framework for providing guarantees and other forms of public support to infrastructure.

The government has invited development partners to support its efforts on three broad fronts. At the national level, priority has been placed on helping to strengthen governance mechanisms and sector reforms through budget support and sector-wide approaches. At the local level, the focus will be on local government capacity building and inter-jurisdictional coordination. Finally, the government has set the goal of fostering private sector involvement in infrastructure through a combination of loans to public and private entities, investments in private projects, and guarantees.