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Chapter 2: Public Investment for the Recovery

The immediate focus of governments during the COVID-19 crisis thus far has been to address the health emergency and provide lifelines for vulnerable households and businesses. Governments now also need to prepare economies for safe and successful reopening, design policies to create jobs and boost economic activity, and facilitate the transformation to more resilient, inclusive, and greener economies. Spending on digital infrastructure will be essential to support social distancing and to narrow the digital gap that exacerbates disparities in access to information, education, and work opportunities.

Chapter 2 discusses the appropriate role of public investment in fostering such a recovery. Before the COVID-19 crisis, public-investment-to-GDP ratios were already declining and the growth in infrastructure had not kept up with needs. Priorities include developing well-resourced and better-prepared healthcare systems, expanding digital infrastructure, and addressing climate change and environmental protection.

In advanced and some emerging market economies, where interest rates are near their effective lower bound, scaling up of quality public investment can have a powerful impact on employment and activity, crowd in private investment, and absorb excess private savings without causing a rise in borrowing costs. For many low-income countries and several emerging market economies—particularly those borrowing in foreign currency—investment is highly constrained by financing conditions, despite massive needs to attain the Sustainable Development Goals. In these countries, policymakers will need to safeguard public investment, to the extent compatible with saving lives and livelihoods, and enhance its efficiency. Moreover, the crisis makes a global response even more necessary to avoid slipping further behind on the Sustainable Development Goals.

Even with social distancing, public investment is feasible and can be delivered quickly if governments take four steps: (1) invest right now in maintenance; (2) review and restart promising projects that were

delayed in preparation or implementation; (3) speed up projects in the pipeline to bring them to fruition within the next two years; and (4) start planning immediately for new projects aligned with postcrisis priorities.

Strengthened public investment management practices and governance are essential because delays, cost overruns, and disappointing projects are common and could be more frequent when investment is scaled up—the cost of an individual project can increase by 10 percent when public investment in the country is high. Satisfying these conditions may not be possible everywhere. But for countries with easy access to finance, borrowing to finance public investments of good quality will be an effective strategy because the global decline in interest rates has set a lower bar for investment projects to be beneficial. For countries with financing constraints, the bar is higher to pass because governments with limited resources face competing spending priorities.

Empirical estimates based on a cross-country data set and a sample of 400,000 firms show that public investment can have a powerful impact on GDP growth and employment during periods of high uncertainty—which is a defining feature of the current crisis. For advanced and emerging market economies, the fiscal multiplier peaks at over 2 in two years. Increasing public investment by 1 percent of GDP in these economies would create 7 million jobs directly, and between 20 million and 33 million jobs overall when considering the indirect macroeconomic effects.

Crowding in private investment is particularly strong in industries critical for the resolution of the health crisis (communications and transport) or for the recovery (construction and manufacturing), but it would have to be accompanied by complementary policies to address high leverage and liquidity constraints faced by private firms.

New investments in healthcare, social housing, digitalization, and environmental protection would lay the foundation for a more resilient and inclusive economy.

Because rates of return on investments in adaptation to climate change are often greater than 100 percent, official aid for adaptation is an effective use of public money. Official aid for climate change adaptation

would have to more than double the \$10 billion allocated currently to around \$25 billion to finance the public investments required for adaptation to climate change in low-income countries.