# Budget Identifier - Definition of capital

Providing basic information on the economic purpose of aid flows—namely that donors indicate the proportion of a flow that is capital spending—would add significant value to data that countries currently have. Public expenditure is in the form of either current spending - on goods and services that are consumed; or capital spending – that creates a productive asset[[1]](#footnote-1). In the context of the Budget Identifier, it has been recommended that only capital investments be separately identified. Other aid flows will be considered recurrent, with the exception of budget support or financing instruments that do not clearly assign final expenditure.

Capital spending is generally defined as “physical assets with a useful life of more than one year. But it also includes capital improvements or the rehabilitation of physical assets that enhance or extend the useful life of the asset (as distinct from repair or maintenance, which assures that the asset is functional for its planned life)."[[2]](#footnote-2) Capital includes all aspects of design and construction that are required to make the asset operational.

**Distinguishing between capital and current costs**

It can be difficult to distinguish between capital and recurrent costs in some cases. It should be generally assumed that the entire project to implement a capital investment, including the project management, design costs and construction costs should be classed as capital. The only time when a component of the project may not be capital is if there is a distinct component of the project that is not specifically required to make the asset operational, such as capacity building for related institutions or an M&E component that is designed to monitor the operation of the asset after completion (monitoring the construction of the asset as it completed would be considered part of the capital investment).

## Capital expenditure in the context of aid

The absence of information on the economic nature of aid flows means that budget documentation cannot show aid flows in an integrated manner with domestic spending. **Most tellingly**, it means that for aid‑dependent countries budget preparation and execution will not be based on comprehensive administrative and economic classifications, as is required by Performance Indicator (PI) 5 of the PEFA Framework[[3]](#footnote-3). Inability to produce an economic classification for a significant part of their resources would result in a D score against this indicator—the lowest score possible.

In the context of the Budget Identifier, only a sub-set of overall aid capital expenditures should be considered and recorded as capital. Capital expenditure should be identified where the government is intended to have a role managing the asset or, more broadly, assets that are expected to require government financing to manage and maintain them during the asset lifetime. The objective being that the government is made aware of the asset and with this knowledge is able to plan for the recurrent expenditure that will be required for its staffing, operation and maintenance.

## When should capital investment be identified?

Capital investment should be identified at the time of **commitment**. If the project is a multi-year project then the recipient government will be able to use the total capital commitment and the timeframe of the project to estimate the capital investment on an annualized basis.

To avoid double counting, only NEW capital that has implied recurrent costs should be identified. For example, capital investments should not be recorded at the time of investment, and again at time of completion or handover. Capital should only be identified AT THE TIME OF INVESTMENT and not time of transfer to government, even if transition to government management is planned for a later date. The reason for this is that governments should be in a position to plan for management and associated costs of capital as soon as an investment is being planned. Some of the associated recurrent costs that the government will take on such as staffing, monitoring or training may begin during the construction phase. For example, a hospital building may be constructed in phases with some of the asset becoming operational before the last construction phases are completed.

In addition, many capital investments will have a recipient co-financing arrangement and the government will need to allocate capital or recurrent costs during the construction phase as part of the project.

## Examples of capital expenditure

Capital that is only for the purposes of the project and is sold or otherwise disposed of (not handed over to government) after the completion of the project should not be counted.

* This includes project cars, computers, printers and other smaller project specific assets if not handed over to the government.
* Project buildings that are disposed of at project completion and not handed over to government should not be identified as capital.

Critical capital expenditure to identify includes roads, rail, ports, airports, dams, schools, water pumps, clinics, government offices, ICT infrastructure among others. Some examples are listed below in Box 1.

## Projects that are only partially capital investment

As discussed in the first section, projects may have multiple components, some of which are capital investment, and some current costs. Where possible, aid flows should make this distinction by identifying only the capital components and leaving out current components. This can be achieved by identifying a share of the project cost that is capital. It may not be possible to be completely accurate, but a best estimate will improve the overall accuracy in these circumstances. For example:

|  |  |  |
| --- | --- | --- |
| Component | Share of total cost | Capital? |
| Project management  | 15% | Yes |
| Road Construction | 75% | Yes |
| Development of road regulatory framework and road safety institutions | 10% | No |
| Total capital share | 90% |  |

**Box 1. Examples of capital expenditure in aid flows.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Asset** | **Method of Acquisition** | **Method of Disposal at project completion** | **Tag as capital?** | **Reason for identifying as capital** | **Justification/explanation of item as capital.** |
| Project office | Bought | Public sale | NO | Asset will not require government to provide recurrent costs for maintenance |  |
| Project office | Bought | Repurposed as a spare parts warehouse and handed over to government ministry/agency | YES | Upon project closure, asset is not disposed of, but becomes a government-managed asset.  | A warehouse or government office needs occasional maintenance |
| Road | Designed, engineered & Constructed | Handed over to government ministry/agency | YES | Asset is a new investment and will require government to take over management and maintenance | A road must have regular maintenance, policing and safety management etc. |
| Borehole drilling rig | Bought for $400,000 | Handed over to Government ministry/agency | YES | Asset is a new investment, is sizeable enough to be considered large capital and will require government to take over management and maintenance |  |
| Borehole | Designed, engineered & Constructed | A public-private partnership scheme is established with community led management | YES | Asset is a new investment, government will have responsibility for oversight and management of overall investments to improve water access | Boreholes will need regular maintenance. Financing for the maintenance may not directly come from the government if there is a public-private partnership scheme, but the government may be responsible for managing parts stores, training maintenance teams, managing large borehole drilling contracts where understanding the inventory of existing assets is crucial. |
| School Building | Designed, engineered & Constructed | Handed over to successor project (new donor or NGO) | YES | Asset is a new investment, while it is not expected to immediately require government recurrent costs for management and maintenance, it may do in the future and does add to the national stock of service delivery capital assets.  | A school building needs teachers, furniture, chalk, text books and basic supplies and occasional maintenance. |
| Clinic | Handed over from predecessor project, current project includes basic maintenance of clinic | Handed over to government ministry/agency | NO | Asset is not a new investment, it should have been tagged as capital in predecessor project. Basic maintenance costs are not capital investment. |  |
| Clinic | Handed over from predecessor project, but a derelict wing is rehabilitated during current project | Handed over to government ministry/agency | YES, but only the cost of rehabil-itation | Asset is not a new investment, it should have been tagged as capital in predecessor project. Rehabilitation IS capital investment so these expenses constitute capital. | A clinic must be staffed, supplied with drugs and basic goods, pay for utilities and have occasional maintenance undertaken. |

1. In the government context, transfers are also typically included as a public expenditure item – these are allocations of resources to actors outside the general government sphere. [↑](#footnote-ref-1)
2. D Jacobs, 2009, [Capital Expenditures and the Budget](http://blog-pfm.imf.org/pfmblog/fad-technical-guidance-notes-on-public-financial-management.html), IMF PFM Technical Guidance Note No 8. (IMF, Washington) [↑](#footnote-ref-2)
3. Public Expenditure and Accountability: http://pefa.org [↑](#footnote-ref-3)