ABBREVIATION AND ACRONYMS

ACI Aid Co-ordination and Effectiveness
BiH Bosnia and Herzegovina
BOT Build-Operate-Transfer
CBA Cost Benefit Analysis
CEFTA Central European Free Trade Agreement
COFOG Classification of the Functions of Government
DFID Department For International Development
DIS Decentralized Implementation System
DPIM Department of Public Investment Management
ESB Extra-Budgetary Fund
EC European Community
EU European Union
GDP Gross Domestic Product
GFS Government Financial Statistics
GiZ Deutsche Gesellschaft für Technische Zusammenarbeit
IFI International Financial Institution
IPA Instrument for Pre-Accession Assistance
IPPI Investment Project Proposal Form
IPS Integrated Planning System
OECD Organization for Economic Co-operation and Development
PBA Program Based Approach
PBB Program-Based Budget
PEM Public Expenditure Management
PIM Public Investment Management
PIP Public Investment Program
PIU Project Implementation Units
PPL Public Procurement Law
PPP Public-Private Partnership
PRSP Poverty Reduction Strategy Paper
RS Republic of Srpska
LPFAM Law on Public Financial Management and Accountability
M&E Monitoring and Evaluation
MEF Ministry of Economy and Finance
MoF Ministry of Finance
MTBP Medium-Term Budget Program
MTDS Mid-term Development Strategy
MTEF Medium-Term Expenditure Framework
NDF National Development Plan
NIP National Investment Plan
NPAA National Plan for the Adoption of the Acquis
NSDI National Strategy for Development and Integration
OBL Organic Budget Law
SAA Stabilization and Association Agreement
SAI Supreme Audit Institution
SAO State Audit Office
SIGMA Support for Improvement in Governance and Management
SOE State-Owned Enterprise
SPEM Strengthening Public Expenditure Management
UNDP United Nations Development Program
USAID United States Agency for International Development

Vice President: Philippe H. Le Houerou, ECAVP
Country Director: Jane Armitage, ECCU4
Sector Director: Luca Barbone, ECSPE
Sector Manager: Bernard Funck, ECSV2
Task Manager: Ronald Hood, ECSP2
TABLE OF CONTENTS

1 INTRODUCTION ..................................................................................................................1

2 PUBLIC CAPITAL EXPENDITURE TRENDS IN THE STUDY COUNTRIES .........................2
   A. Total Capital Spending as a Share of GDP .................................................................2
   B. Capital Spending as a Share of Public Spending .........................................................3
   C. Functional Composition of Capital Spending .........................................................3
   D. Allocation of Public Capital Expenditure between Levels of Government ..............4
   E. Capital Budget Performance ..................................................................................5

3 SYNTHESIS OF COUNTRY PRACTICES: SHARED CHALLENGES AND POSITIVE EXPERIENCES ......6
   A. Institutional Framework ......................................................................................6
   B. Strategic Setting ..................................................................................................8
   C. Identification, Preparation and Appraisal of Capital Investment Projects .............10
   D. Budgeting for Capital Investment .........................................................................14
   E. Procurement and Capital Budget Implementation ...............................................16
   F. Evaluation and Audit of Completed Projects .........................................................18

4 TENTATIVE PROPOSALS FOR FOLLOW-UP WORK FOR A SECOND STAGE OF THE STUDY .........19
   A. Cross-Country Issues ......................................................................................19
   B. Follow-Up Issues by Country ............................................................................21

5 METHODOLOGY .............................................................................................................27

APPENDIX 1: PUBLIC INVESTMENT MANAGEMENT PRACTICES BY COUNTRY ....................30
   A. Albania ..............................................................................................................30
   B. Bosnia ............................................................................................................36
   C. Kosovo ..........................................................................................................42
   D. Macedonia .....................................................................................................47
   E. Montenegro ......................................................................................................52
   F. Serbia ...........................................................................................................58

APPENDIX 2: KEY FEATURES OF A WELL FUNCTIONING PUBLIC INVESTMENT MANAGEMENT
   SYSTEM AND RELATED DIAGNOSTIC QUESTIONS .............................................64

TABLES

Table 1: Total Capital Spending as % of GDP (2003-2008) ......................................................2
Table 2: Total Capital Spending as % of Total Public Spending (2003-2008) .........................3
Table 3: Composition of Capital Expenditure by Function 2007 (% of total capital expenditure) ..............4
Table 4: Actual Capital Expenditure as % of Approved Budget ............................................5

BOXES

Box 1: Guidance from International Good Practice ...........................................................7
Box 2: Albania’s Integrated Planning System ................................................................9
Box 3: Advantages of Preliminary Project Screening at Identification Stage ..................11
Box 4: Cost-Benefit Analysis: Key Features, Advantages, Limitations and Role in PIM .......12
Box 5: A Possible Presentation for Multi-Annual Projects in an Annual Budget ..............16
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1 INTRODUCTION

1.1. This report summarizes the findings of a review of public investment management (PIM) practices in the Western Balkans carried out with an eye to improving practices over the medium term, sharing experiences on a regional basis, providing some initial specific recommendations and identifying areas for more intensive further analysis. It is draws from six individual country reports detailing practices in Albania, Bosnia, Kosovo, Macedonia, Montenegro and Serbia which have been written in a common format to facilitate comparison, but which can be read as stand-alone pieces. Throughout, the analysis has been organized around the following six headings which reflect a structured survey questionnaire devised for preparation of the report:

- Institutional Framework
- Strategic Setting
- Identification Preparation and Appraisal of Capital Investment Projects
- Budgeting for Capital Investment
- Procurement and Capital Budget Implementation
- Evaluation and Audit of Completed Projects

1.2. Following this introduction, the second section of the Main Report examines capital expenditure trends in the study countries. The third section provides an overview of the findings across the six countries. The fourth section proposes potential drill-down topics for the further analysis. The fifth and final section briefly outlines the methodology used in the individual country studies. More detailed analysis of the PIM practices by country is provided in an appendix which presents the summaries from the six separate country reports. The structured survey questionnaire is also provided as an appendix.
2 PUBLIC CAPITAL EXPENDITURE TRENDS IN THE STUDY COUNTRIES

2.1. While the main focus of the study is on public investment management systems, we begin with a brief examination of public capital expenditure trends in the six study countries in order to make comparisons between countries. To the extent possible, official statistics on various dimensions of public capital spending over recent years have therefore been collated for each country, as follows:

- Share of public capital expenditure in the economy
- Relative importance of capital spending in total public expenditure
- Functional composition of capital expenditure
- Allocation of public capital expenditure between levels of government
- Significance of external financing
- Capital budget performance (outturn vs. budget expenditure)

2.2. It is a measure of the relative development of budgetary systems in some of the countries that it has not been possible to assemble a comparable set of financial data for each of these dimensions from readily available financial statistics and there are therefore some important gaps in the cross-country analysis. Albania has the most comprehensive financial statistics from among the six countries followed by Kosovo.

A. TOTAL CAPITAL SPENDING AS A SHARE OF GDP

2.3. With only a small number of gaps, a more or less complete time series for total capital spending as a percentage of GDP is available for the six countries for the period 2003-2008, as shown in Table 1. Differences in definitions and coverage mean that it may not be wise to use these statistics as a basis for precise inter-country comparisons, but they are adequate for drawing broad conclusions on trends and differences between countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>4.6</td>
<td>5.0</td>
<td>4.6</td>
<td>5.7</td>
<td>5.8</td>
<td>8.6</td>
</tr>
<tr>
<td>Bosnia</td>
<td>4.5</td>
<td>4.3</td>
<td>4.4</td>
<td>3.8</td>
<td>4.5</td>
<td>n/a</td>
</tr>
<tr>
<td>Kosovo</td>
<td>n/a</td>
<td>6.7</td>
<td>6.0</td>
<td>4.6</td>
<td>3.8</td>
<td>8.3</td>
</tr>
<tr>
<td>Macedonia</td>
<td>4.1</td>
<td>3.1</td>
<td>3.6</td>
<td>2.8</td>
<td>3.8</td>
<td>5.0</td>
</tr>
<tr>
<td>Montenegro</td>
<td>2.7</td>
<td>1.8</td>
<td>4.6</td>
<td>4.5</td>
<td>7.0</td>
<td>10.1</td>
</tr>
<tr>
<td>Serbia</td>
<td>2.5</td>
<td>2.6</td>
<td>2.7</td>
<td>4.0</td>
<td>4.7</td>
<td>n/a</td>
</tr>
<tr>
<td>Average Share</td>
<td>3.7</td>
<td>3.9</td>
<td>4.3</td>
<td>4.2</td>
<td>4.9</td>
<td>7.8</td>
</tr>
</tbody>
</table>

*Source:* National authorities and World Bank staff estimates

2.4. The figures in Table 1 reveal that most of the countries have increased the share of public capital spending in GDP over the period, but in three out of the six countries - Albania, Kosovo and Montenegro - the share increased extremely steeply from 2007 to 2008. As GDP has been rising, at least till 2008, this also means that there have been significant increases in real expenditures on capital. Bosnia is the only country not to have followed the regional trend with the share at the end of the period being much the same as at the beginning. More recently, capital spending has likely become compressed as a result of fiscal adjustments related to the effects of the global financial crisis.

2.5. Montenegro has experienced the most impressive increase in the share of public capital spending, rising from a low of 1.8 percent in 2004, when it was well below the regional average, to reach the highest share in the region, at 10.1 percent, in 2008. Albania too has seen remarkable growth from 4.6
percent of GDP in 2005 to 8.6 percent in 2008. Much of this growth is accounted for by a single priority in the transport sector, the road to Kosovo, which has been absorbing a large and increasing share of the capital investment budget.

2.6. In Kosovo, the share fell consistently between 2004 and 2007, only to be reversed in 2008 by a huge increase of 4.5 percentage points in one year. Serbia has seen steady growth, but the share of GDP going to public capital spending still remains below the regional average. Macedonia has shown no clear trend and its share has been below the regional average throughout the period.

2.7. Only for Albania and Bosnia has it been possible to obtain a breakdown of the share of capital spending by funding source (domestic and external). In Bosnia, the proportion of foreign-financed public investment has increased from around half to just over three quarters over the period. In Albania, the share of foreign financing was falling until 2007, when it reached 16 percent, only to rebound to 45 percent in 2008, when an increase in the availability of external resources explains all the increased share of GDP made up of public investment.

B. CAPITAL SPENDING AS A SHARE OF PUBLIC SPENDING

2.8. In the five countries for which figures are available, a distinction can be made between Albania and Kosovo on the one hand, and Bosnia, Macedonia and Serbia on the other: in these first two countries capital represents a much higher share of total public spending than it does in the latter group.

2.9. The share of public spending going to capital in Albania and Montenegro has been growing strongly, rising from 15.6 percent and 6.4 percent, respectively, in 2003 to 26.4 percent and 20 percent, respectively, in 2008. In Kosovo, the share varied between a fifth and a quarter of spending between 2004 and 2007, but leapt to 36.8 percent in 2008 as capital spending grew much faster than other areas of public spending.

2.10. In Bosnia, Macedonia and Serbia, capital spending was in the region of 10 percent of total public spending in 2007. For Serbia, this represented an increase over the low of 5.6 percent in 2003, for the other two countries there had been no distinctive trend in previous years. Recently, in Macedonia, the share has increased in two consecutive years to reach a high of 14.4 percent in 2008, but still short of Albania's starting point in 2003.

C. FUNCTIONAL COMPOSITION OF CAPITAL SPENDING

2.11. Broadly comparable figures on the functional composition of capital expenditure are only available for three of the six study countries for one year, 2007.

2.12. Only Kosovo and Serbia are using functional classifications that are consistent with GFS/COFOG 2001. Albania is using a classification that is consistent with GFS/COFOG 1986. The figures for Albania
can therefore be mapped against Kosovo and Serbia for most of the major functional items, except for 'environmental protection'. Since this is likely to be a relatively small component of expenditure, the figures given in Table 3 can be considered broadly comparable.

2.13. As would be expected, economic affairs, which includes the infrastructure-intensive sub-functions of transport and energy, is the most important component of capital expenditure in all three countries. There are, however, significant differences between the two thirds of capital spending going towards economic affairs in Albania, the half share in Kosovo and the one third share in Serbia. The composition of spending within economic affairs is not available for Serbia and Kosovo, but for Albania transport infrastructure represented 86.9 percent of spending within this function (56.2 percent of capital spending).

2.14. In some other areas there are also considerable variations between countries. Serbia for instance is spending a very high proportion of the capital budget on defense (18.1 percent) and public order and safety (18.6 percent) compared to the other two countries. Both Kosovo and Serbia direct significant shares of capital spending to ‘general public services’ (23.5 percent and 19.6 percent, respectively) compared to Albania. Housing and community amenities, on the other hand, receive a significantly higher share of capital spending (10.4 percent) in Albania compared to Kosovo and Serbia, particularly the latter (1.5 percent).

2.15. Some of the divergences between the three countries are so large as to suggest differences in either the application of definitions (functional or economic) or in the coverage of the budgetary figures. This suggests that there may be comparability issues and that further work might be required to obtain a fully comparable set of data.

2.16. A sector breakdown was available for Macedonia, but the classification currently being used is not COFOG-consistent or map-able against COFOG. The classification includes a ‘construction’ category that is not strictly a function of government and can be expected to include capital spending in a number of different functional areas.

### D. ALLOCATION OF PUBLIC CAPITAL EXPENDITURE BETWEEN LEVELS OF GOVERNMENT

2.17. Figures on the distribution of capital spending between different levels of government could only be obtained for Albania, Kosovo and Montenegro. In 2008, local government spending on capital was broadly similar in Albania and Kosovo at 14.4 percent and 15.0 percent respectively, having declined considerably from highs of 23.2 percent in Albania in 2005 and 30.8 percent in 2004 in Kosovo. In  

### Table 3: Composition of Capital Expenditure by Function 2007 (% of total capital expenditure)

<table>
<thead>
<tr>
<th>Functional Item</th>
<th>Albania</th>
<th>Kosovo</th>
<th>Serbia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defense</td>
<td>5.8</td>
<td>3.1</td>
<td>18.1</td>
</tr>
<tr>
<td>Economic Affairs</td>
<td>64.7</td>
<td>50.0</td>
<td>34.2</td>
</tr>
<tr>
<td>Education</td>
<td>7.1</td>
<td>2.6</td>
<td>5.5</td>
</tr>
<tr>
<td>General Public Services</td>
<td>5.0</td>
<td>23.5</td>
<td>19.6</td>
</tr>
<tr>
<td>Health</td>
<td>4.5</td>
<td>4.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Housing &amp; Community Amenities</td>
<td>10.4</td>
<td>6.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Public Order &amp; Safety</td>
<td>0.9</td>
<td>8.5</td>
<td>18.6</td>
</tr>
<tr>
<td>Recr. Culture &amp; Religious Affairs</td>
<td>0.6</td>
<td>1.2</td>
<td>0.5</td>
</tr>
<tr>
<td>Social Security &amp; Welfare</td>
<td>0.6</td>
<td>0.2</td>
<td>2.0</td>
</tr>
<tr>
<td>Other Expenditure</td>
<td>0.4</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Environmental Protection</td>
<td>n/a</td>
<td>0.3</td>
<td>0.0</td>
</tr>
</tbody>
</table>

*Source: National authorities and World Bank staff estimates*
Montenegro, municipal capital spending represented 57.8 percent of the total in 2007, financed almost entirely from municipal own-sources.

E. CAPITAL BUDGET PERFORMANCE

2.18. Execution data were not available for Bosnia and Serbia.

2.19. The figures on capital budget execution for Albania and Kosovo indicate broadly improving performance. In Albania in 2003, the capital budget had only been executed at a rate of 70.4 percent compared to the 89.4 percent achieved in 2008. In Kosovo, execution stood at 85.7 percent in 2008 compared to the low of 60.6 percent in 2004. The figures for Macedonia also indicate similarly improving performance, but with a significant over-spend of 11 percent in 2007 compared to the budget as originally planned. Figures for Montenegro for show execution to have been very close to the approved budget in 2007.

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>70.4%</td>
<td>86.4%</td>
<td>98.0%</td>
<td>86.7%</td>
<td>93.2%</td>
<td>89.4%</td>
</tr>
<tr>
<td>Kosovo</td>
<td>n/a</td>
<td>60.6%</td>
<td>87.5%</td>
<td>70.1%</td>
<td>78.1%</td>
<td>85.7%</td>
</tr>
<tr>
<td>Macedonia</td>
<td>n/a</td>
<td>n/a</td>
<td>76.3%</td>
<td>77.0%</td>
<td>111.1%</td>
<td>92.7%</td>
</tr>
<tr>
<td>Montenegro</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>94.2%</td>
<td>100.7%</td>
<td>100.5%</td>
</tr>
</tbody>
</table>

Source: National authorities and World Bank staff estimates
3 SYNTHESIS OF COUNTRY PRACTICES: SHARED CHALLENGES AND POSITIVE EXPERIENCES

3.1. The best public investment management systems will fail to produce results if they are undercut or circumvented by ad hoc decisions. This section presents a synthesis of public investment practices across the six countries. There are lessons to be learned in as much as some countries have advanced well in certain areas, and other countries in other areas. However, good systems will not perform well if they are not followed in practice. For instance, rigorous project screening processes will be ineffective if they are overruled by political choices in the final selection process, or if requirements for monitoring and evaluation are simply not observed. It is therefore crucial, having established what best practice is, to make sure that it is actually practiced.

A. INSTITUTIONAL FRAMEWORK

3.2. The study has revealed frequent weaknesses in the institutional arrangements for public investment management, although in most cases things are moving in the right direction. Box 1 sets out some stylized guidelines on good practice for institutional arrangements for public investment management, based on what is commonly found in OECD countries. The box describes systems involving a single, integrated budgeting process for capital and recurrent expenditure, within which capital expenditure is clearly distinguished from current expenditure because of its particular characteristics (i.e., the potential scale of expenditures; the long-term nature of costs and benefits, including inter-generational considerations; and its importance for public service delivery and economic development). An integrated approach ensures that an appropriate balance between the two types of expenditure is achieved within expenditure programs and that the operating and maintenance costs of investment proposals are not forgotten. A fully integrated approach needs to be introduced at four levels, the first two of which have implications for the way public investment management is organized at the centre of government:

I. Organizational and staffing integration, i.e., no separation of responsibilities for capital and recurrent between organizations or between departments

II. Integrated budget preparation, i.e., the same staff are responsible for recurrent and capital budgeting;

III. Unified budget documentation and presentation; and

IV. Unified reporting and accounting systems.

3.3. For a variety of reasons, including significant volumes of external assistance, all the countries have some experience of fragmented institutional arrangements for public investment, although to differing degrees. The study has revealed that all countries have been working to remove this fragmentation at the four levels listed above, but at different paces and with differing degrees of success.

---

Box 1: Guidance from International Good Practice

In most developed countries, budgeting for capital expenditure is fully integrated within the core budget processes managed by the Ministry of Finance. Key elements of the process include the following:

- Capital project appraisal and preliminary project approval: The Ministry of Finance in a developed economy will not usually undertake investment appraisal, but it will lay down conventions that it requires Budget Users to apply but in some cases may examine the appraisal very closely. Preliminary approval may then be given, but funding remains dependent on the Budget User finding room in its capital budget;

- Approval of the Budget User’s capital expenditure budget: This will normally be agreed at the same time as approval of the current expenditure budget, together with certain understandings as to how it will be spent, which in a developed economy may be at a very high level (e.g. defined only in terms of outputs) but in a transitional economy it will be fairly detailed given the existence generally of capacity constraints and a large informal economy;

- Reporting of all capital expenditure to be used by Government in the general Budget, regardless of source or use, for approval by Parliament;

- Capital project procurement, capital project management and unusual capital financing: These are issues in which the Ministry of Finance usually has a close interest in procedures and good practice across the whole of Government; and

- Capital project monitoring and evaluation: In a developed economy, the Ministry of Finance will check progress and expect to be consulted on impending serious problems on major capital projects. In a transitional economy, the Ministry of Finance is also normally directly concerned with the progress of donor assisted projects...

Organizationally these tasks would generally be undertaken by those officials in the Ministry of Finance (and in Budget Users) that are responsible for aspects of budget planning, preparation, monitoring and evaluation on a sector basis. In this way the relevant Ministry of Finance staffs establish a good knowledge and understanding of the sector priorities and programmes and of the many possible trade-offs between alternative projects, between options within single projects, and between capital and current spending...

The important point here is that it is good international practice for effective public expenditure management to ensure that all resource allocation decisions for capital spending be made in accordance with the budget cycle regardless of the size or source of the capital.'


3.4. One of the biggest challenges is integrating externally-funded public investment into mainstream processes. In this regard, all six countries have now brought responsibility for programming externally-funded projects back under their respective finance ministries, but not all have moved to a situation where there is full integration into the usual organizational arrangements for budgeting. The existence of PIPs running in parallel to the budget process is often a sign of continuing problems in this area. Bosnia, in particular, still has considerable way to go before PIP preparation becomes integrated with the budgetary processes. Other countries, like Macedonia, have been making more concerted efforts to integrate the PIP into budgetary processes, but with only partial success, while Albania has dispensed altogether with a separate PIP. One, probably undesirable, tendency is for some countries to set up parallel arrangements for EU accession funding. EU funding does indeed require the establishment of some special accounting and accountability arrangements, but this should not be used as
a reason for segregating its management from country budgetary systems; the better approach is to improve country systems so that they meet EU standards.

3.5. **Albania has perhaps moved furthest towards the institutional arrangements described in Box 1.** It has brought responsibility for externally-funded public investment back under the Ministry of Finance and it has created a Department of Public Investment Management (DPIM) under the General Budget Directorate. Budget preparation and analysis is organized along sector lines under the responsibility of the Department for Budget Analysis, Policy and Programming (also within the General Budget Directorate), in coordination with the DPIM. The DPIM is mainly concerned with ensuring that quality control procedures (or ‘screening’) are being followed and with monitoring the investment program. A sensible distinction is therefore being made within the MOF between coordination of the project selection process, which is part of budgeting, and overseeing project screening processes, which need not be synchronized with the budget cycle.

3.6. **Even though the design of institutional arrangements has progressed in Albania, the reforms are relatively recent and there is still considerable work to be done to make them work effectively.** The DPIM, especially, is short of the necessary human resources to carry out its everyday oversight and monitoring functions. Similar deficiencies are a feature of the public investment units in the other five countries and considerable efforts are now required to increase staff numbers and skills.

**B. STRATEGIC SETTING**

3.7. The strategic setting for public investment planning and decision-making has been found to be one of the weakest links in many public investment management systems. Government officials consulted during the surveys have frequently complained of the absence of credible and operational strategic guidance from the political level upon which to base project identification, prioritization and selection decisions. Credibility depends on buy-in at the political level, demonstrated affordability and continued relevance. Well articulated and tightly defined strategic objectives and logical coherence are required to make strategic guidance operational.

3.8. Weaknesses exist both at the level of national strategy development and at the sector level. There are several examples of initially promising, but now largely stalled, national strategy development processes, e.g., Kosovo Development Strategic Plan, the Bosnia Mid-Term Development Strategy and the Serbia Poverty Reduction Strategy. Initiated with the strong ‘encouragement’ of the international community and supported by external technical assistance, these strategies have not succeeded in sustaining sufficient political momentum and have consequently had limited impact on public investment planning. They also often suffer from vagueness, inadequate costing of programs and incompatibility with realistic resource constraints, limiting their usefulness. At the sector level, there are frequent important gaps in sector coverage, often in relation to sectors with infrastructure shortfalls, and where strategies have been developed they often suffer similar deficiencies to national strategies, e.g., lack of internal consistency, unreliable cost estimates, unrealistic expenditure plans. Vertical coherence between plans at different levels in the planning hierarchy and horizontal coordination are also common problems.

3.9. **By introducing an Integrated Planning System, Albania (see Box 2) seems to have made the most progress in establishing a sound strategic planning framework with strong linkages to budgeting and other processes.** Although there has been substantial external support in establishing the system, and more will be required, this has coincided with a strong demand from a reform-oriented
Government and the whole process now has political ownership at the highest levels. The National Strategy for Development and Integration is not without weaknesses and there are still gaps in the underlying sector strategies, but the system has taken hold, is improving and is now beginning to provide greater policy orientation for public investment management. Macedonia has also put significant effort into upgrading its strategic planning process and linking ministry strategy development and review directly to a medium term budget framework, but the results have so far been disappointing, partly because political buy-in has not been sufficient.

3.10. In theory, renewed impetus for national strategy development could come through the EU accession process. In practice, the experience with the new member states has been mixed at best. Still an opportunity exists: the European Commission requires all EU candidate countries to have a National Development Plan in order to be eligible for EU pre-accession funding. At this stage, only Macedonia is a candidate but, in time, National Development Plans could become important focal points for strategic thinking, potentially with a wider scope than as instruments limited to securing and channeling EU financial assistance (as happened in Ireland, where the National Development Plan is genuinely national in its scope). Bosnia is already anticipating this requirement and has begun preparation of the BH Development Strategy, although the process is not without its difficulties.

3.11. There is a substantial interest in different types of PPP arrangements as a means of delivering improved public infrastructure, but coherent strategies and policy guidance are largely missing. This is an important area with potentially high risks for the public sector finances if things go wrong; the current, seemingly, ad hoc approaches to deciding whether to pursue PPP in a particular sector are inadequate and more needs to be done to establish a framework for decision-making. Some work has been, and is being, done on developing laws, but more needs to be done to set out government policies regarding PPP and on setting out the conditions for preferring it over the more traditional procurement approaches.

Box 2: Albania’s Integrated Planning System

Recognizing that Albania’s policy and financial planning systems had been fragmented and disjointed, the Government of Albania in November 2005 committed itself to the implementation of an Integrated Planning System (IPS). The IPS provides a planning and monitoring framework for the government’s core policy and financial processes. Within the IPS framework two main processes are specified: (i) the National Strategy for Development and Integration which will provide a single comprehensive strategy covering all sectors; and (ii) the MTEF/budget process requiring line ministries to elaborate their medium-term expenditure plans so as to deliver their policy objectives and goals within each ministry’s expenditure plan. The IPS also emphasizes a requirement for stronger strategic direction from the Council of Ministers (CoM) which will in future approve the initial fiscal framework and resource ceilings for the MTEF and Budget as well as the strategies developed by each ministry.

Three structures are being established to oversee implementation of the IPS: (i) an inter-ministerial Strategic Planning Committee chaired by the Prime Minister; (ii) a Government Modernization Committee chaired by the Deputy Prime Minister; and (iii) the Department of Strategy and Donor Coordination (DSDC) located within the CoM Secretariat and responsible for coordinating IPS across government. Implementation of the IPS is being undertaken as a phased process. The initial focus during 2006 was on establishing the central structures and developing the basic IPS methodologies and processes. During 2007 the aim was to extend the basic IPS processes to all ministries, with broadening and deepening of these processes taking place in the years since.

Source: Kosovo Policy Note on Public Investment Management, Andrew Bird, World Bank, October 2007
C. IDENTIFICATION, PREPARATION AND APPRAISAL OF CAPITAL INVESTMENT PROJECTS

3.12. In some cases the scope of projects is set too narrowly so that the public investment management system is populated with too many small projects. This is particularly a problem in Albania and Kosovo where it is leading to a higher administrative burden, a loss of strategic focus and increased costs. For example, integral parts of a single, larger infrastructure investment are sometimes being defined as separate projects or else multi-year projects are being split into annual tranches, with each defined as a separate project. Very similar, small projects in different locations that might be better grouped together as 'programmatic' projects are also being kept separate. This is often in spite of reasonable conceptual definitions of what constitutes a project having been set down. This does not seem to be an issue in Serbia, Montenegro and Macedonia, nor in the case of externally-funded projects where the funding agency's definition of a project usually applies.

3.13. Some form of systematic pre-implementation procedures are usually present to ensure that investment projects are properly designed and justified, but there is substantial variation across countries in the content, analytical depth and areas of applicability of these procedures. In the better examples, the procedures apply to all public investment projects irrespective of the funding source. They also specify the use of rigorous analytical methods for verifying value-for-money, e.g., economic cost-benefit analysis, and of appropriate impact assessments. The weaker examples place more emphasis on engineering feasibility and costs, and pay less attention to assessing demand and quantifying benefits. In some cases, reasonably well designed procedures are only being applied to a subset of investments.

3.14. Albania and Kosovo have probably gone furthest in introducing properly sequenced and disciplined procedures linked to a structured review and approval process. The procedures apply equally to all projects whether they are externally or domestically funded. Importantly, the Albanian procedures also include an identification and preliminary screening step, where consistency with policy objectives and project logic are first assessed, and a decision is taken on whether it is worth proceeding to preparation - Box 3 sets out the advantages of preliminary screening. Both countries have a step where a formal appraisal decision is taken, focusing mainly on ascertaining whether a project is likely to offer value for public money. There is a requirement to examine project alternatives and basic performance parameters for later monitoring and evaluation are defined during preparation. Responsibilities for decision-making and the criteria to be used are clearly set down.

3.15. In Albania and Kosovo, the sophistication of project appraisal and the supporting analytical studies is made proportional to the scale of project. Proposals for this kind of approach are also under consideration in Montenegro. 'Proportionality' means that cost-benefit analysis (CBA) is only required for projects above a certain threshold value. This provision recognizes that, in spite of its usefulness as a rigorous analytical tool for assessing the value for money of project proposals, CBA requires skilled practitioners and is intensive in its use of planning resources: CBA is therefore best focused on the largest projects where the potential costs of making mistakes are greatest. The thresholds need to be kept under review to ensure that they have been set at an appropriate level. It is sometimes better to set them high and enforce them rigorously, than to set them too low and find that they are unenforceable because too many projects are covered. This is the approach that seems to be being pursued in Montenegro, where the proposal is for CBA to be a required for projects in excess of €15 million.
Box 3: Advantages of Preliminary Project Screening at Identification Stage

A preliminary filtering process for project concepts at identification stage has a number of significant advantages and can raise the overall quality of the investment program:

- It forces project promoters to clarify the project logic (the problem being addressed, the purpose of the project and the target beneficiaries), and to consider alternative solutions before dedicating resources to project preparation.
- Project objectives can be verified at an early stage for compliance with government policy and expenditure priorities, and the project can be rejected where this consistency cannot be demonstrated.
- The scope of the project can be verified to ensure that it represents a complete solution to the problem being addressed and not just a component of a larger project.
- Where project preparation is unlikely to inform the investment decision further, screening at identification stage forces an early decision on priorities and helps to prevent resources being used up preparing unaffordable or irrelevant projects. An example would be the case of social projects where cost-benefit analysis is difficult to perform and the investment decision is more policy-based.
- By requiring rough cost estimates at identification stage, it is possible to determine whether and when the project can be fitted under medium term capital expenditure ceilings within the MTEF.
- Early recognition of any significant recurrent financing needs allows more time to develop the necessary coherence between the capital and current parts of a spending agency’s budget.
- Any important design issues, including possible project alternatives, can be identified early and built into the terms of reference for studies.
- The preliminary screening process disciplines spending agencies, by guiding them towards priority areas for investment and causing them to think in terms of developing a ‘pipeline’ of projects for implementation within MTEF limits.

Monitoring and evaluation results from ongoing and completed projects can be fed more easily into the later project preparation stage.

3.16. When it is difficult or too costly to value benefits, CBA has further limitations beyond its demands on skilled personnel, which do not always seem to be fully understood. Box 4 looks at the advantages and disadvantages of CBA and sets out some guidelines on its role in a public investment management system. The general lesson is that procedures need to be supple enough to allow the use of alternative methods (e.g., cost-effectiveness analysis or multi-criteria analysis) where appropriate. In the end, the most important requirement is for a view to be taken on the balance between the costs and benefits of a project using systematic and transparent methods, even if these might sometimes lack the quantitative rigor of CBA.

3.17. The quality of project preparation is generally poor, even in those countries with more advanced pre-implementation procedures. Projects are often being promoted without a systematic assessment of whether they might represent good value for public money, including scrutiny of underlying assumptions and sensitivity to risk. Where formalized preparation procedures exist, these are often followed only superficially, treated more as a bureaucratic exercise than as an aid to decision making. The focus of pre-implementation studies is frequently on engineering feasibility and costs, at the expense of demand forecasting and benefits estimation. Very limited use is being made of the more sophisticated project appraisal techniques, like CBA, even when this is a requirement. Project alternatives are rarely examined.
Box 4: Cost-Benefit Analysis: Key Features, Advantages, Limitations and Role in PIM

Key features
Economic cost-benefit analysis (CBA) aims to quantify in monetary terms as many of the costs and benefits of an investment proposal as feasible, including items for which the market does not provide a satisfactory measure of economic value. The purpose is to provide the information necessary to answer two key questions relating to efficiency and effectiveness:

- Are there better ways to achieve this objective?
- Are there better uses for these resources?

CBA is a methodology for assessing the net benefits accruing to society as a whole (not just the operating entity) as a result of a project or program. It considers the flow of real resource costs and benefits over a project’s life and includes estimating costs and benefits that are ‘un-priced’ and not subject to normal market transactions, (e.g., public goods and negative and positive externalities). Allowances are made for distortions to market prices (through monopoly power, trade restrictions, labor market rigidities) and the value of indirect taxes and subsidies are excluded as these represent transfers within society and not the real use of resources. Costs and benefits occurring at different points in time are quantified on a comparable basis, by discounting to arrive at present values.

Advantages
CBA is a rigorous approach focused on the value added from an investment and if properly used can increase the objectivity and transparency of investment decisions. It makes the link between inputs, outputs and outcomes explicit and considers gains and losses to all members of society. Impacts are valued in terms of a single, familiar measurement scale - money - and can therefore in principle show that implementing an option is worthwhile compared to doing nothing.

Limitations
Although it is a valuable approach when used wisely, CBA has certain limitations that were not always foreseen when the methodology was first developed and promoted as a universally applicable ‘scientific’ decision-making tool. Although there have been advances in some areas, e.g., valuing environmental costs and benefits, difficulties in valuing project outputs explicitly have prevented its application in ‘...the great majority of areas of public policy, such as law and order, defense, employment, regional, industrial, education, health, or public administration...’ and a more pragmatic approach is now applied. Because of differences in valuation techniques and approaches, it is also often difficult to use CBA to make reliable comparisons between projects from different sectors (or even subsectors), even where benefits and costs are more readily quantifiable. Therefore the use of CBA as a prioritization tool is generally limited to individual sectors or subsectors.

While the use of money values has its advantages it can also give a false sense of accuracy, and there is a danger of ignoring costs or benefits which are not easy or too expensive to quantify. The results from a CBA are highly dependent on the choice of discount rate (itself not a straightforward matter) and susceptible to ‘planners’ optimism’ (a general tendency to under-estimate costs and over-estimate benefits). Another important disadvantage is that, as a result of information asymmetries, spending agencies can ‘cook the books’ if rate-of-return thresholds are set by central agencies because results can be easily manipulated by skilled technical experts to give positive outcomes. Not the least of the limitations is that CBA is intensive in its use of skilled human resources and requires trained and experienced practitioners.

Role of CBA
CBA is usually a very important part of project preparation in developed PIM systems and a key input into the

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2 Public Investment and Discounting in European Union Member States, M. Spackman, OECD Journal of Budgeting, 2001
3 See Spackman, 2001, for a discussion of the theoretical basis for determining the discount rate and differences in their practical application in EU member states.
appraisal stage. Its principle use is as a screening tool for identifying the set of good projects that can be then be considered for funding. It is also useful for prioritizing projects within specific sub-sector investment programs, e.g., inter-urban roads, irrigation, power, and for choosing between different project design options. Because of its intensive use of skilled human resources, it is often better practice to subject only the largest projects (where mistakes are more costly) to economic analysis.

Where benefits are difficult to quantify, cost effectiveness analysis (CEA) of projects should be performed. This is analysis that compares the costs of alternative ways of producing the same or similar outputs and aims to determine the costs of achieving a specific physical target. Benefits are expressed in physical units and not money values; costs are expressed in money terms and discounted to determine their present value. The results of the analysis are usually expressed as cost per unit output (or outcome if possible). CEA is useful in areas like health and education where it is more difficult (but not necessarily impossible) to quantify benefits in monetary terms.

<table>
<thead>
<tr>
<th>3.18. A shortage of staff with the necessary project appraisal skills is obviously part of the problem, but demand-side considerations are probably equally important. A value-for-money culture has not yet taken root among senior government officials and decision-makers in many of the countries, leading to weak incentives to develop and retain the necessary skills. The fact that there are some examples of good feasibility studies for major projects having been initiated by governments, often using local consultancy companies, suggests that capacity constraints may not always be the critical factor.</th>
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<td>3.19. A deeper understanding of the constraints facing the adoption of more advanced project appraisal methods is probably required, but the initial suggestion is that a two-pronged initiative will be needed. This would involve promoting the use of more objective tools to senior management and decision-makers combined with carefully targeted capacity building. The central public investment units in the individual countries are best placed to lead such an initiative, but as already indicated they are generally facing their own capacity constraints. A desirable medium term objective for all countries would therefore be to build the capacities of their central public investment units so that they can become centers of excellence for project appraisal and evaluation methods within the administration, disseminating good practice to spending ministries by issuing guidelines, offering advice on specific cases and organizing training.</td>
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<td>3.20. Few systems for independent peer review of appraisal results exist, but Serbia’s ‘revision commissions’ offer a promising model. These ad hoc commissions, which are made up of independent external experts, review preliminary feasibility and feasibility studies. The commission’s recommendations, which must be applied, are submitted in a report to the promoter. Their effectiveness depends on the strengths of their membership and on the degree of political momentum already behind projects. The drawback is that the role of the commissions is somewhat narrowly defined to technical engineering matters and a wider remit extending to the efficiency and effectiveness of a proposed investment would be more useful.</td>
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<td>3.21. In very few cases has detailed methodological guidance on cost-benefit analysis been issued. For those countries that have not developed their own guidance, translating the 2008 EC ‘Guide to the Cost-Benefit Analysis of Investment Projects’ into the local language could be a good starting point, although it would need to be issued with some provisos about what is specific to EU-funded projects, e.g., calculation of co-financing obligations. One of the most important aims of such guidance should be to bring clarity to the distinction between financial and economic analysis, about which there still exists a good deal of confusion in the study countries.</td>
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D. BUDGETING FOR CAPITAL INVESTMENT

3.22. There is still a difference between the definition of capital expenditure being applied and international practice in a number of the study countries. A category of expenditure named ‘heavy repairs’ or ‘investment maintenance’ is often being used which mixes rehabilitation or improvement of existing assets (both capital expenditures) with the periodic maintenance required to maintain the performance of an existing asset. The critical factors to be considered are whether the expenditure increases the performance or capacity of an asset or extends its life beyond what was initially planned, in which case, it is capital. Scheduled, periodic expenditures required to utilize a fixed asset over its expected service life and which do not change the asset or its performance are current expenditure.

3.23. Lack of comprehensiveness when it comes to budget coverage of capital expenditure is a widespread problem, although it is more severe in some countries than in others. The difficulties associated with bringing externally-funded public investment on budget is the biggest issue. This clearly affects the aid-dependent countries, like Bosnia, more severely. Another important issue relates to investment funds constituted from privatization proceeds which can either be entirely off budget or not presented in sufficient detail if on budget, e.g., a single line item for all expenditures. In some cases, donors or IFIs still find it impossible to use national budgetary systems for their projects because of continuing weaknesses; even so, ways can usually be found, as a minimum, to reflect these expenditures in budgets and in financial reporting and accounting, even if this requires parallel procedures. Serbia has found a way of doing this and some proposals have been put forward for Bosnia.

3.24. Finance ministries are not performing a credible ‘gate-keeping role’, i.e., ensuring that no project enters the budget without first having passed through the necessary appraisal process and received the prescribed approvals. The result is that project selection is still heavily politicized in most countries. Where pre-implementation procedures are weakly specified, it is obvious that there is no basis for gate-keeping. But even in countries where procedures are reasonably well specified, investment units in finance ministries have difficulties ‘holding the line’. Albania, for example, has sound procedures in place but is not immune from significant numbers of projects that are unplanned and motivated by short-term political considerations from being pushed onto the budget at the last moment. Partly this is because of limited internal capacities of investment units, but it can also be due to the comparative weakness of the MOF in political terms compared to some of the larger spending ministries.

3.25. Most countries are already budgeting in a medium-term perspective, or else moving towards it, but credibility is often lacking. Moving away from a single-year focus is always slow and establishing the authority and reliability of the new processes does take time to attain. Credibility depends to a large extent on whether the ceilings that are decided through an MTEF process become firm constraints for annual budget preparation (and execution) and on whether ceilings for outer years are good predictors of future budget allocations, thus enabling stable strategic planning.

3.26. One of the major problems is the lack of alignment between MTEFs and budgeting, so that they are more or less parallel processes and MTEF ceilings have little or no impact. In those countries where there are Public Investment Programs (PIP), e.g. Bosnia, lack of alignment between this instrument and the MTEF and the annual budget can also be problematic. Albania has tackled the issue of alignment through the Integrated Planning System (see Box 2) which ties medium term planning and annual budgeting into a single seamless process and ensures that ceilings are realistic and binding. The country’s progress in this area has been achieved because of high-level political momentum in combination with well-timed technical assistance, but there is still substantial work to be done.
3.27. A number of countries now require comprehensive information on capital spending by project, including total estimated cost and past and forward expenditures for multi-year projects, to accompany the budget. This ensures that decision-makers and legislators are aware of forward spending implications of their expenditure choices and a tighter control is maintained over total project costs. The Kosovo Law on Public Financial Management and Accountability sets out the requirements of a capital spending plan required as an accompaniment to the budget. Similar requirements are specified in Albania's new organic budget law and a revision of the Serbia's Budget System Law proposes a medium-term investment plan to be drawn up to accompany the Budget Memorandum. Likewise, Macedonia now requires plans for development programs, which should give detailed multi-annual expenditure forecasts for individual investment projects, to accompany budget submissions. While one would not necessarily expect to find the detail contained in these plans as part of the budget in an OECD country, it does seem appropriate to the stage of development of budgetary planning systems in the study countries. Box 5 presents a suggested model for the basic information requirements for presenting multi-annual projects in the budget.

3.28. By allowing the introduction of new projects in the middle of the year, the practice of voting supplementary budgets frequently undermines the discipline of the annual budget process. While a certain amount of flexibility is necessary for efficient and effective capital budget execution, a balance has to be struck between adequate flexibility and creating the right incentives for good project planning. The possibility of being able to make substantial revisions, including adding or dropping projects, combined with the flexibility offered by virement rules, means that poor capital expenditure planning is not being penalized and the incentives for improvement are absent. Often supplementary budgets are voted to spend unexpected increases in revenues and these are very often directed at capital spending. This is typically the worst possible use of such ‘windfalls’ which are frequently wasted on hastily and badly prepared projects. An important element of resolving this problem will be improvements in revenue forecasting leading to more reliable resource forecasts in annual and medium term budget plans and moderating one reason for frequent supplementary budgets.

3.29. In no cases are there systematic checks on implementation readiness as part of the budgetary process and this is one reason for the disappointing and uneven rates of budget execution for capital expenditure (see Section 2.). Lack of detailed technical designs, unfinished land expropriation and missing procurement plans are examples of the kind of problems encountered in all of the countries once the budget year begins and which might be avoided by having some basic checks in place. In the absence of these checks, and of penalties for poor planning (see above), there remains a strong tendency to leave implementation planning until after budget approval, and even later, resulting in delays.

3.30. The future recurrent consequences of capital expenditure decisions are rarely thought through. Fully integrated recurrent and capital budget planning is, therefore, still a long way from being achieved in most of the countries. The medium-term budgeting processes being instituted are beginning to create the right environment for integrated planning, but even in Albania, where there is an explicit requirement to plan for the future operating and maintenance costs of new capital assets, this is not yet being taken seriously enough.
Box 5: A Possible Presentation for Multi-Annual Projects in an Annual Budget

Budget submissions for new investment projects would include:
1. Total Estimated Cost of completing the project;
2. Budget funding for the budget year in preparation; and
3. A financial implementation plan showing funding by source (including non-budget sources) and by year until project completion.

Items 1 and 2 would appear in the approved budget, while item 3 would be provided as supporting information to the budget document. Financial implementation plans must be realistic and consistent with the Total Estimated Cost of the project. A realistic financial implementation plan has all the sources of finance assured and is consistent with the technically efficient physical implementation of the project.

In this context, budget approval for funding a new project would mean approval of funding for the budget year in question and approval of the Total Estimated Cost of the project. Approval of the Total Estimated Cost means agreement in principle to funding future years’ expenditure of multi-year projects, conditional on resource availability and in accordance with the principle that funding for efficient implementation of ongoing projects shall be given priority over funding for new projects.

Budget submissions for ongoing projects would include:
1. Total Estimated Cost (original and revised);
2. Estimated total expenditure to the end of the current budget year;
3. Estimated Cost to Completion from the start of the budget year in preparation;
4. Budget funding for the budget year in preparation; and
5. Revised financial implementation plan by year for the remainder of project implementation.

Items 1-4 would appear in the approved budget. Item 5 would be provided as supporting information to the budget document.

The Total Estimated Cost of a project may change from year to year based on allowable variations in inflation or physical factors not anticipated in the original estimate. Changes in Total Estimated Cost would then be approved through the budget process. In addition, significant increase in real costs might trigger a re-examination of economic feasibility (making allowance for sunk costs) as is the case in South Korea.

E. PROCUREMENT AND CAPITAL BUDGET IMPLEMENTATION

3.31. Adequate public procurement legislation, embodying the basic public procurement principles of transparency, non-discrimination, competition and legal recourse, is in place everywhere. Public procurement arrangements are being designed to promote cost-effective procurement and economical use of public funds. Open and competitive procurement is now enshrined as the preferred method and the statistics show that the majority of procurement is now performed in this way. The laws are not yet fully harmonized with EU directives and international good practice, but any divergences are gradually being rectified.

3.32. Although the legislative framework has improved, more still needs to be done to improve implementation. Mostly this means more training of procurement officers to work in spending agencies in applying the approaches embodied in the law: several of the countries reported delays in capital budget execution as a direct result of a lack of capacity to implement procurement plans because of a shortage of qualified public procurement professionals. Retention is also an issue as procurement specialists are much in demand by private sector bidders for works contracts. The central bodies set up to
oversee implementation of the procurement laws are usually also facing human and financial capacity constraints, limiting the pace at which they can bring about the necessary changes in capacities.

3.33. **There were frequent complaints from budget holders in most countries about long implementation delays caused by respecting new procurement arrangements.** In fact, the tender periods specified in most of the laws are not out of line with international standards and the real problem is often a failure on the part of budget holders to plan properly for procurement. The procurement processes can be overly bureaucratic though, imposing some extra costs on bidders.

3.34. **A narrow emphasis on selecting the lowest priced bid at the expense of other important qualitative factors has been identified as a particular problem in Montenegro and Albania, but may also be an issue in other countries.** This means that 'best value' procurement criteria are not being applied, in spite of being allowed within the law, with the result that there are often problems during implementation resulting in delays and cost increases. In the case of Albania, evaluators seem to be risk averse because of fear of subsequent investigation of their evaluation decisions by the external audit organization. In Montenegro, there may be some of this, but the suspicion is that there could also be some governance issues.

3.35. **The small size of the local market and the limited number of potential bidders for works contracts have been identified as particular concerns in Kosovo and Montenegro.** The result is that there is less competition and sometimes less than the minimum number of bidders, requiring re-tendering and implementation delays. As well as these practical concerns, small markets with few rival companies create greater potential for collusion and anti-competitive behavior. The World Bank has been looking at some of these issues in the context of Kosovo. One possibility would be to exploit the forward looking provisions of regional trade agreements such as SAA and CEFTA to widen the scope of tenders to regionally based suppliers so as to enhance competition.

3.36. **Corruption in public procurement remains a significant concern in spite of the advances in the legislative framework and its application.** Reform of the law and methods is only part of the solution to reducing corrupt practices by making them more visible and easier to trace. International experience demonstrates that, in general, strong leadership by example from the highest levels is also required in the fight against corruption. This seems to be the area where more effort will be required. Increasing use of e-procurement, which is just starting in some countries, also offers opportunities by further increasing transparency.

3.37. **Most organic budget laws and procurement laws allow multi-year contracting within the framework of annual budgets.** These are often relatively new innovations and there remains a strong tendency in some countries, e.g. Kosovo, to continue procuring smaller annual projects when larger projects would make more sense. This leads to fragmented investment programs, higher administrative costs and higher construction costs. In Bosnia, where multi-year contracting is restricted, these additional costs are an unavoidable part of the system.

3.38. **There is much interest in PPP arrangements, but very few countries have an adequate conceptual and analytical framework in place for adequately assessing the value for money and risks of individual proposals and for arriving at a decision.** The basis for decisions is therefore often opaque. PPP laws have been or are being drawn up; these are useful, but they need to be supported by a decision-making framework, including criteria for selection. Public servants need to be aware of the risks and limitations of PPP and to understand when they need to call upon the services of experts so as to avoid the public sector taking on undue risk. This is an area that requires further investigation because all the countries seem to be following this route but without adequate directions.
3.39. In several countries, notably Bosnia and Macedonia, the system of setting up PIUs to implement donor-financed projects has proved problematic. PIUs have largely been established as parallel administrative structures with little impact on the development of project implementation skills and capacities in national spending ministries. While there is general agreement in principle to moving away from the system, donors are reluctant to use country systems, particularly financial systems, in their current state. Recipient countries must therefore expect to have to upgrade their own systems first.

3.40. Modern treasury systems are generally in place, but it is not always clear that these systems are being used to their full potential to assist project managers and budget holders in the financial management of investment projects. Evidently, this is the case for those projects that are off-budget and using parallel systems, but for those projects that are on budget, treasury systems seem capable of becoming the basis of more dynamic management tools than currently exist. In some cases, e.g., Albania, technical problems with the treasury system are actually impeding potential improvements to the public investment management system.

3.41. Systematic and responsive monitoring is not generally being performed by the finance ministries and there are few checks in place to ensure that budget holders have good systems. Monitoring tends to be infrequent and passive and concerned with financial progress only. Physical and performance monitoring are rare and feedback loops are generally missing.

3.42. Independent supervision of works contracts is a requirement everywhere. Although evidence is obviously hard to come by, anecdotal evidence suggests that there is frequent collusion between supervisors and contractors. Further work is required to gauge the extent of this problem and possible solutions.

F. EVALUATION AND AUDIT OF COMPLETED PROJECTS

3.43. Ex post evaluation of public investment projects is systematically weak. While it is important to begin developing an evaluation system, this might not initially be as important as other areas of public investment management: both monitoring and evaluation require an effective project planning system to be in place first so that there are baseline implementation plans and performance targets against which to measure and assess progress. All the same, it is evident that this is an area where more work is now required in all six countries so that the first steps are taken in establishing a prototype evaluation process, even if the initial focus has to be limited to financial performance (planned costs compared to out-turn) and the explanations, rather than an ex post assessment of wider project performance against plans (value-for-money and achievement of project purpose).

3.44. Supreme audit institutions have now been set up everywhere, but none are yet carrying out performance audits of public investment projects. The effectiveness of the various SAIs varies significantly between countries depending upon how long they have been in existence and how well they have been resourced. Most of their work consists of basic compliance audits, but capacities to carry out financial audits are increasing and these are a standard part of the work in several countries. Performance audits are being trialed in Macedonia and Albania, but at the program level, not for individual projects. None of the countries seems to be close to having their SAIs play an active role in public investment management; nevertheless, well targeted, one-off evaluations of particularly poorly performing projects could be one way of focusing attention on better planning and early verification of efficiency and effectiveness. Depending on their financial capabilities, SAIs could consider bringing in external expertise to carry out such assessments.
4 TENTATIVE PROPOSALS FOR FOLLOW-UP WORK FOR A SECOND STAGE OF THE STUDY

A. CROSS-COUNTRY ISSUES

4.1. All countries now have public investment units located in their finance ministries, but their capacities are generally weak and their roles often not well defined. There is scope in all the countries for identifying capacity strengthening needs and measures so that these units can coordinate the PIM process better and promote the application of more rigorous preparation and appraisal methods.

4.2. Only in Albania is there a formal identification and preliminary screening step in the pre-implementation phase of the project cycle (and even in Albania the procedure is not yet strictly adhered to). There are numerous advantages to such a procedure and further investigation of how it might be introduced in all countries would be worthwhile.

4.3. Except for externally financed investments, rigorous project appraisal techniques are rarely used, even where they are a requirement. Shortage of skilled practitioners is undoubtedly a factor, but lack of demand from decision-makers often seems to be a more important explanation. While there is more work to be done in determining the critical constraints to a more systematic application of these analytical methods, it could well be that targeted awareness raising among senior officials and decision-makers could be the most effective way of promoting their adoption.

4.4. In none of the countries are explicit checks on implementation readiness applied during budget preparation. The result is that projects that are lacking important preparatory work are often approved and then subject to delays during implementation. There is scope for looking further into this issue and for developing firmer proposals for tightening up budget preparation procedures.

4.5. Public-private partnerships, particularly concessions arrangements, are being enthusiastically pursued in the region. Some countries already have PPP and concession laws and others are in the process of preparing them: so, a legal framework is being put in place. In practice though, the rationale for this approach does not seem to have been clearly thought out and there is little or no guidance available on what factors should determine when to prefer a PPP solution over traditional procurement. The result is a frequently ad hoc approach to PPP with governments more often responding to unsolicited proposals than implementing their own coherent policy. Lack of transparency is also a frequent problem. The concern is that a PPP approach may not always be being pursued for the right reasons and that there might be underlying governance issues. This study has only been able to take a superficial look at this area and there is more probing to be done in all six countries.

4.6. The practice of voting mid-year supplementary budgets seems to be common in the region and seems to impact disproportionately on capital spending. In recent years, supplementary budgets have been designed to spend ‘unexpected’ revenue increases, which have usually been directed more than proportionally towards capital spending. This frequently results in poorly prepared projects being implemented too quickly with negative implications for value for money. It also undermines the credibility of the annual budget process. More needs to be done to explore the extent, causes and results of this problem.

4.7. Concern has been expressed in nearly every country about the professionalism and independence of consultants supervising works contracts. The suspicion is that there is frequent collusion between supervising consultants and contractors, resulting in uncontrolled cost escalation once contracts have
been let. There may be transferrable lessons from other countries, particularly some new EU member states, that could be applicable in the region and more research in this area would be valuable.

4.8. Ex post evaluation is largely undeveloped across the region. Although a good evaluation process probably needs to be preceded by improved project planning, with a stronger results and value-for-money orientation, there is a need to begin laying the foundations for a better system. Further work is therefore required to decide what a rudimentary evaluation process might look like and how it might fit with the existing elements of the public investment management system. Some well targeted, one-off evaluations, either by government or by the supreme audit institution, could also act as a stimulus for the improvements in planning mentioned above.

4.9. The report has limited its focus to public investments funded through government budgets (at all levels). In most of the countries this excludes expenditures that might well be termed public investments but which are made by state-owned enterprises or similar corporate entities created by local governments. Investments in infrastructure for electricity, drinking water and waste water are common examples. While investments made by such SOEs are not on budget, the SOEs themselves can interact significantly with public budgets. The SOEs may create large contingent liabilities. They may receive subsidies or transfers from the budget. There may be other important public financial considerations associated with tariff setting and regulation. In Kosovo for instance, the state electricity company places an enormous and unsustainable burden on the budget. Finding a solution to this problem will require additional investment, possibly with public or donor financing or guarantees, as well as regulatory reforms. We have not considered this wider class of issues here. However, in future work it might be worth doing so perhaps in a specific sector/country context.

4.10. It may be desirable in future work to focus on an individual sector such as roads or energy which account for a significant share of public investment and embody certain sector specific challenges that can yield useful cross-country lessons. This might be done in conjunction with the issue addressed in the previous paragraph.

4.11. Implementation practices in certain areas may be deserving of closer examination that go beyond legal frameworks and broad best practice guidelines. For instance, while procurement has been mentioned in this study as an important aspect of PIM, it would be good to examine the more nitty-gritty procurement design and strategy aspects of this, such as the type of tender, bidder eligibility criteria, package size and component bundling and market timing. Similarly, there are some basic practical design considerations in project finance: how to make optimal use of donor funds; where and what type of PPPs is appropriate; or how to deal with cost overruns, design changes, and implementation lags. In drilling down into these issues, it may be necessary to take individual sectors or cases studies as these may be more revealing than more general analysis can be.

4.12. Finally, the view of the PIM systems presented here is largely drawn from experience over a period of unprecedented growth and revenue over performance. This is now turning into a period of marked slowdown. What was a pattern of over-reaching and under-fulfillment of capital budgets is giving way to disproportionate mid-year cuts in capital spending. We might want to reflect on this in the next round highlighting the need to improve revenue forecasting, to respect the annual budget cycle, to avoid treating capital as a residual and to avoid spreading resources too thinly over too many projects by failing to make hard choices about what to drop.
B. FOLLOW-UP ISSUES BY COUNTRY

Albania

4.13. Significant advances have been made in the last few years in strengthening public investment management (as well as other aspects of public expenditure management) and the challenge now is to bed down these reforms. Support for this purpose is coming through the IPS\(^4\) Trust Fund and care must be taken not to duplicate any of its activities. There are, however, a number of areas where follow-up work would be appropriate in the short-term.

1. The role of the PIM unit in the MOF seems to be reasonably well defined and it is appropriately situated in the organizational structure; however, the unit requires improved capabilities to perform its designated role. Concrete proposals on capacity building needs could therefore be developed and these might serve as a basis for designing support through the IPS Trust Fund.

2. The public investment management procedures have been in operation for two years and it would probably now be worthwhile undertaking a more in-depth review of their application to determine whether and where any improvements might be made, particularly with respect to project implementation. At the same time, requirements for supporting guidelines could be defined, and their scope and content outlined.

3. In spite of efforts to adopt a more strategic project definition and to accommodate multi-year projects, there has been limited progress in reducing the number of investment ‘projects’. Further work in finding an explanation for this phenomenon is required, including unraveling the basis for the blockages caused by the apparent limitations of the treasury system or by constraints on those responsible for operating it.

4. Progress has been made on developing upstream aspects of public investment management, but the development of the monitoring and evaluation (M&E) function is lagging behind. This is perhaps understandable since active M&E needs to be based on reasonable planning. Even so, there now seems to be an opportunity for moving forward on this front. Work on upgrading monitoring has already begun, but institutional arrangements for follow-up now need to be firmed up. Evaluation remains a largely undeveloped area and the design of a rudimentary evaluation process would now be timely as one element of instilling a value-for-money culture in the public service.

5. There is an urgent need to develop a more systematic policy for using PPP/concession arrangements. At the moment, these arrangements are being pursued in an ad hoc fashion with no structured and transparent criteria for deciding when to prefer them over traditional procurement. A report on the operation of the concession framework has already been produced with Bank assistance, but it seems that limited attention has been paid to the findings and recommendations, so follow-up is indicated.

Bosnia

4.14. Two DFID-funded projects have recently commenced that aim, amongst other things, to bring about improvements in public investment management in Bosnia. The Aid Co-ordination and

\(^4\) Integrated Planning System
Effectiveness (ACE) Project aims to improve the planning, programming and management of external assistance so that it is in line with the country’s development priorities. The third phase of the Strengthening Public Expenditure Management (SPEM) Project aims to deepen the medium term budget planning process already commenced under earlier stages of this assistance and, specifically, begin implementing a strengthened capital budgeting process in line with recommendations made during the second phase. In the light of this assistance, it seems appropriate that any follow-up work by the Bank should be focused on other stages of the public investment management process and should be closely coordinated with these two projects.

4.15. Bearing in mind this ongoing support, the areas where the Bank could add further value in the near term are identified as:

1. The Federation rule-book dealing with aspects of the pre-implementation phase of the project cycle needs to be reviewed and possibly revised after several years in operation. There is no equivalent in the Republic of Srpska and it would therefore be useful to investigate further the development of universally applicable process for project preparation.

2. Both Entities are currently preparing PPP laws; depending on their current state of development the respective governments might value an external review of these laws. Whatever the case, the legal framework will need to be supported by clear guidance and training on assessing, negotiating and implementing PPP and concession arrangements, with a particular emphasis on ensuring transparency at every step.

3. Little progress has been made on inter-entity coordination in the area of public investment and yet the economic advantages of such coordination, particularly in transport and energy where there is the potential for wasteful duplication, seem too great to be ignored. Further work in identifying, and possibly quantifying, the costs of this failure and to identify some pragmatic ways forward could be valuable, but would obviously be constrained by political factors.

Kosovo

4.16. The country report for Kosovo has identified some significant weaknesses in all stages of the public investment management process. A major EU-funded project is about to begin that will address many of the issues raised in the report in relation to pre-implementation procedures and capital budgeting. With the purpose of improving the quality of planning and budgeting of public spending and public investments in preparation for EU funds, the main areas of assistance will cover:

- development of budget planning process/system for public institutions at central and local level;
- design of an effective public investment planning framework;
- advisory services on policy prioritization, planning, budgeting and managing EU funds; and
- training and on-the-job coaching to public institutions on public financial management.

4.17. Taking account of this assistance, the focus of any Bank initiated follow-up work should therefore be on later stages of the project cycle, although it would make sense to discuss the findings of the country report with the project team for the EU project once in place.

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5 Euro 3.5 million of IPA funding. The goal of the project is to improve the quality of public investments in Kosovo and prepare the ground for EU funds.

22
4.18. While the discussion of Kosovo points to a number of important weaknesses that will need to be resolved over the medium to longer term if public investment management is to be improved, several issues suggest themselves as possible areas for immediate follow-up in Kosovo. These are:

1. Both conceptually and practically there seem to be problems in defining what constitutes a project, resulting in too many smaller, annual 'projects'. Further investigation of the causes of this and identification of possible solutions would seem to be worthwhile.

2. A sequenced pre-implementation process for project development is in place (although not yet being fully complied with), but it does not include a formal identification and preliminary screening step. In coordination with the EU-funded project, the advantages of such a step and its possible introduction need to be investigated further. This links to the point above since this is also the point at which the integrity of a project can be first assessed.

3. Kosovo is pursuing PPP approaches to public investment financing, but seemingly without a firmly based rationale for the policy and with no well defined criteria for selecting such approaches over traditional procurement. There is scope for developing a more structured approach to PPP that ensures that this approach is only used when it delivers demonstrated advantages in terms of value for public money and risk transfer to the private sector.

4. The small size of the domestic market and the limited number of local contractors pose particular problems for the competitiveness of the procurement process in a small country like Kosovo. The World Bank has already been giving some specialist advice in this and other areas of public procurement, but there may be scope for further follow up on and mainstreaming of the guidance already given.

5. The FreeBalance accounting and reporting system is a powerful tool, but it is not being used to its full potential for monitoring purposes. There is more work to be done here to ascertain how FreeBalance might be used to better serve the monitoring of individual projects and of the investment program as a whole.

4.19. There are also some broader concerns relating to the PFM system as a whole, with direct implications for PIM, e.g., national and sector strategy development, strengthening the MTEF process and improving implementation of the public procurement process. Notwithstanding their importance, these are issues that will probably have to be addressed in a wider forum and over a longer time frame.

**Macedonia**

4.20. For a number of years, improvements in public investment management processes seem to have been lagging behind wider reforms in strategy development and public financial management in Macedonia. This shortcoming is of particular concern in the context of the EU accession process. Recent attempts to mainstream the PIP, by reorganizing responsibilities within the MOF and making the link between the first year of the PIP and the annual budget more direct, go some way to addressing the deficiencies, but there are further outstanding issues:

1. The PIP remains largely detached from the evolving medium term budget planning processes. There is therefore room for further investigating how the PIP might be strengthened so that it serves a more useful function or, alternatively, considering a more radical solution. This work should include looking at a more clearly defined role for the directorate charged with responsibility for the PIP.
2. There is a growing consensus that expenditure on public investment has frequently not represented good value for public money in Macedonia and that something needs to be done to improve the situation. Unfortunately, national expertise in the analytical methods for demonstrating value for money remains extremely limited. The newly created directorate with responsibility for public investment (and the PIP) should be taking the lead in promoting the use of the appropriate analysis techniques so that investment decisions are more soundly based. To take on this role, the directorate’s skills probably need to be substantially upgraded. Further work should therefore include a training needs assessment.

3. As well as formal training, on the job training could be important in developing the capacities of the directorate. This might involve economic appraisal of a very limited number of potential ‘white elephant’ projects that are in the pipeline, or ex post evaluation of a small sample of completed projects where there is a suspicion that value for money has not been achieved and where there might be lessons to be learnt for preparation of future projects. The main purpose of these exercises would be to enhance the skills of the unit while at the same time demonstrating the usefulness of the techniques to decision-makers and the public.

4. The Strategic Investment Committee has been formed outside the recently created strategic planning framework and risks duplicating or undermining the process. At the same time, high level political input into investment decision-making is very important and this body, which has obviously been formed because of perceived weaknesses in existing processes, could play an important part in an improved PIM system. Finding a way to harness the political impetus of the Strategic Investment Committee within a more structured PIM system is therefore an important challenge.

**Montenegro**

4.2. Montenegro has benefited in the past from assistance from USAID, GtZ and UNDP in various aspects of the PIM system. This assistance - advice, manuals and tools - does not seem to have been fully exploited by the authorities and the reasons for this are important questions to follow up. Taking this into account, there are a number of areas that present themselves for follow-up in Montenegro:

1. The public investment unit in the finance ministry is relatively weak and needs strengthening. Recommendations to this effect were produced several years ago with USAID assistance but were never acted upon. These recommendations need to be revisited with a view to reinvigorating them, revising them if necessary and finding a way around the institutional blockages that have prevented implementation. The aim should be to set out a well defined role for the unit, determine the capacities required to fulfill this role and to make an assessment of any specific training needs.

2. The strategic dimension of public investment planning is weak: there is no overarching national strategy nor are there sector investment strategies. The Government is aware of this and wants to do something about it. Further discussion of how a more strategic approach to investment decision-making could be incorporated into a more coherent overall strategic planning framework might therefore be beneficial.

3. Methodological guidelines on project appraisal and project cycle management, which were prepared with assistance from GtZ, have not been properly assimilated into Montenegro’s processes. It will be important to investigate further why this is the case and what can be done to ensure that this material serves its purpose.
4. Donor-financed capital spending is not being picked up by the budget in spite of the existence of an I.T. tool developed with UNDP assistance for facilitating the collection and analysis of the necessary information. The reasons for this and whether the tool can still serve a useful purpose merit further investigation.

5. A draft decree on new project preparation procedures has been prepared. The initial view is that this will offer advantages over current procedures, but a more detailed external review could offer an opportunity to make further refinements based on international experience before implementation.

**Serbia**

4.22. The Country Report for Serbia has identified a number of important areas of the public investment management system requiring strengthening. Some of these improvements will only result from more broadly based and longer term reform efforts, while others are potentially susceptible to more specific and more immediate interventions. Of the latter, the following seem to be the most urgent and worthy of further investigation:

1. The public investment unit in the Ministry of Finance is very small and missing a well defined role in the PIM system, having been somewhat overshadowed by the Ministry for the National Investment Plan. Further discussions with the MOF on the appropriate role, staffing and capacity building for this unit could prove fruitful.

2. A new law on construction is about to be adopted. A review of the implications of this law for PIM would be useful, including links to capital budgeting and identification of any needs for additional supporting guidance and training.

3. Strategic planning in Serbia is fragmented and as a result the strategic orientation for public investment is weak. The strategic direction given by the Council for Infrastructure Development is a positive development, but there is still room for creating a more cohesive planning system with stronger institutional foundations. This will be particularly important in the context of EU integration and the programming of IPA funds. Further investigation in this area could be useful to the government.

4. Revisions to the Budget System Law propose the preparation of a medium-term plan for public investment to accompany budget submissions. The draft law does not detail what this entails and advice on a firmer specification of the plan’s contents and preparation process could be helpful for the Ministry of Finance.

5. Establishing a sound framework for setting up viable PPPs to deliver improved public infrastructure is a pressing issue. The Government has been working intensively on drafting PPP legislation and timely assistance in this area might be welcomed. International practice on budgeting and accounting for such arrangements are important issues, particularly with respect to the budgetary treatment of any resulting contingent liabilities, and this could be one theme for deeper work.

6. A process of decentralizing investment decision making is under way and from 2009 local governments have been able to borrow and enter into PPP agreements. Monitoring and managing the associated fiscal risks is an issue that requires urgent attention.
4.23. Institutional arrangements for PIM in Serbia (i.e., existence of a separate ministry with responsibility for a significant share of the investment budget) are not ideal, but arriving at a more suitable solution will take time and political opportunity. As a consequence, this is not seen as an area where further work by the Bank would bear fruit at this juncture.
5 METHODOLOGY

5.1. The starting point for the analysis in each of the counties has been a list of key features\(^6\) that should normally be found to exist in a sound public investment management system. Organized under the main facets of public investment management, these key features are:

a) **Strategic Setting for Public Investment Planning and Decision Making**

*Key features of good practice:*

- Credible, operational and authoritative strategic guidance for public investment planning and decision making.
- A coherent approach to mobilizing funding from different sources, including donors and the private sector.

b) **Identification, Preparation and Appraisal of Capital Investment Projects**

*Key features of good practice:*

- A robust, yet pragmatic, accounting definition of capital expenditure.
- A conceptual definition of ‘the project’ that supports strategic planning and budgeting.
- Properly sequenced and disciplined procedures for identification, preliminary screening, preparation and appraisal of projects, with formal decisions at key steps, including a decision to proceed to detailed preparation after preliminary screening.
- Independent peer review of appraisal results to check for subjective bias, where ministries and departments (rather than a central unit) are responsible for feasibility studies and appraisal.
- Formal and readily accessible methodological guidance on the technical aspects of project preparation and appraisal, proportionate to the scale and scope of projects.
- Formal guidelines and decision criteria for analyzing alternative procurement arrangements, e.g., traditional contracting as against alternative PPP options, BOT, etc.
- Upstream training initiatives in project analysis methods.

c) **Budgeting for Capital Investment**

*Key features of good practice:*

- Capital spending clearly distinguished within a unitary budget.
- A comprehensive coverage of capital expenditure in the budget.
- Explicit recognition of future commitments to ongoing (multi-year) projects in the annual budget or accompanying supplementary information.

\(^6\) These key features were compiled from a survey of previous work in this area:

2. Questionnaire devised for background research for the ‘Study of Public Investment Management in the New EU Member States’, World Bank, November 2007
3. Self-completion questionnaire used at the Istanbul Workshop on Experiences in Public Investment Management, organized by the World Bank in February 2008

27
• ‘Gate-keeping’ procedures to stop projects that have not been screened, i.e., passed through designated pre-implementation procedures, from entering the budget.

• A budget preparation process that:
  o Provides the unique route for selecting projects for funding;
  o Is framed within a medium term perspective;
  o Establishes realistic, but hard, expenditure limits for public investment, enabling spending ministries to prioritize their capital expenditures effectively over time, selecting sound, new projects that address their strategic priorities, while continuing to implement ongoing projects efficiently; and
  o Ensures planning of expenditures required to operate and maintain existing fixed assets and additions to assets.

• ‘Ready-to-go’ checks to ensure that plans (including procurement plans) are in place, for efficient and timely implementation before the budget year begins.

d) Procurement and Capital Budget Implementation

Key features of good practice:

• Competitive, efficient and transparent procurement and contracting procedures aimed at delivering economy in the use of public resources.

• Ability to make multi-year contracts within the framework of an annual budget.

• Project management arrangements with clear lines of accountability for delivering agreed project outputs on time and to budget.

• Robust project accounting and cost control systems.

• A responsive monitoring process, involving regular reporting and timely identification and resolution of potential problems.

• Adequate flexibility to respond to material changes in project circumstances, e.g., significant real cost increases or benefit decreases, by re-designing or permanently halting projects.

• Independent verification of works during implementation and before acceptance of completed projects.

• Maintenance of up to date asset registers and recording of asset values.

e) Evaluation and Audit of Completed Projects

Key features of good practice:

• Systematic ex post evaluation of completed projects.

• Feedback mechanisms, ensuring evaluation results feed into new project design and project selection decisions.

• Supreme Audit Institution with the mandate and capacity to undertake performance audits of projects, as well as financial/compliance audits.

5.2. A structured survey questionnaire (see Appendix 1) was designed to assist in assessing the extent to which these features were apparent and functioning in each of the countries. Responses to the survey questions were obtained through interviews with officials, discussions with World Bank colleagues and other members of the donor community, and from reviews of relevant secondary sources.
5.3. Guided by the responses to the questionnaire the country reports assess the extent to which the key features of a functioning public investment management system are present or absent in each country. As well as identifying any gaps, the country reports attempt to highlight any promising developments towards filling gaps.
This appendix contains the summaries from the six individual country reports, upon which the overview report is based. It is provided for the convenience of those readers who do not wish to go into the level of detail provided by the country reports. For those readers who wish to understand the situation in one or more of the participating countries more closely, the full country reports (approximately 40 pages each) are available on request.

A. ALBANIA

Institutional Framework

1. Strategic planning and budgeting have become closely linked in Albania through the Integrated Planning System (IPS). The IPS unifies the existing national medium- to long-term strategic planning process (the National Strategy for Development and Integration - NSDI) and the medium-term budgeting process (the Medium Term Budget Program - MTBP) while ensuring that other core processes, including public investment management and external assistance management, are fully reflected within this streamlined system. All the evidence suggests that the system is beginning to meet its goal of providing a broad planning framework within which the Government's core policy and financial planning processes function in a coherent, efficient and integrated manner.

2. The Ministry of Finance has overall responsibility for public investment management and exercises this responsibility principally through the Department of Public Investment Management (DPIM) within the General Directorate for Budget. The DPIM was established specifically to introduce a more coherent approach to public investment within the framework of the Integrated Planning System and Medium Term Budget Program. Its work involves managing implementation of the recently introduced procedures for screening, appraisal and approval of projects and monitoring implementation. So as to achieve an integrated approach to budgeting, the DPIM works with the Department for Budget Analysis, Policy and Programming (also under the General Directorate for Budget) during budget preparation, ensuring that capital expenditure requests are analyzed alongside current expenditure.

3. The recently enacted new organic budget law sets down a process for preparation, analysis and approval of the annual State Budget that is set firmly within a medium-term planning framework (the Medium Term Budget Program) and has a strong performance orientation. The budget is classified by program (as well as the standard budgetary classifications) and budget preparation is organized around these programs. Program policy goals and objectives are established (on the basis of strategic plans) and the outputs necessary to achieve these objectives identified. Budgeting then consists of costing the activities (including investment projects, which are defined as sets of activities) required to deliver the specified outputs, and prioritizing outputs so as to remain within top-down expenditure constraints (ceilings). The latter are formulated to ensure macro-fiscal stability and allocate resources to reflect the Council’s of Ministers strategic objectives. Analysis of budget requests and assessment of budgetary performance (including capital expenditure) is intended to be focused on outputs, in particular, the efficiency of their delivery and their effectiveness in contributing to desired policy outcomes. This is a significant departure from the more traditional line item budgeting that preceded it.
Strategic Setting

4. In the National Strategy for Development and Integration (NSDI) 2007-2013, Albania now has a realistic, coherent and authoritative basis for the planning and prioritization of public investment projects, which is supported at the highest levels of the Government. Founded on a national vision and supported by costed sector and crosscutting strategies, the NSDI and its component parts have been developed within a realistic macroeconomic and fiscal framework. Specific guidance on economic infrastructure (transport, energy, wastewater and sanitation, and environment) is provided, setting out the challenges, vision and strategic policies and priorities by sector. External assistance is now being more closely coordinated with strategy development, through the Department of Strategy and Donor Coordination at the Council of Ministers.

5. The quality and coverage of the individual sector and crosscutting strategies underpinning the NSDI is variable and further deepening and widening efforts are therefore required, now that the basic strategic planning framework is in place. Preparation of the better sector strategies benefited from technical assistance and the IPS Trust Fund will therefore be useful in making progress in other sectors. Improvements in the timeliness and frequency of reviewing progress in implementing the NSDI may also be required: ideally, this would need to be on an annual basis and linked to the budget preparation cycle. Maintaining the prominence of the NSDI as the central medium- to long-term policy-making tool over successive electoral cycles also presents a challenge.

6. In contrast to external assistance, the approach for mobilizing private sector financing for public infrastructure remains disorderly. There is no overall strategy guiding the use of concessions and other PPP arrangements and most activity has consisted of responding to unsolicited proposals, largely in the energy (hydro-power) sector. There is therefore an urgent need to develop a more systematic policy for using PPP.

Identification Preparation and Appraisal of Capital Investment Projects

7. Although there have been some improvements in the way capital expenditure and projects are being defined conceptually, weaknesses remain in the way these concepts are being applied in practice. In particular, the budget continues to be populated with a large number of small, domestically-funded investments, some of which are very similar in design and others of which are integral parts of much larger investments. Consolidation of these smaller projects into larger units for analytical and decision-making purposes has not been happening to the desirable extent, leading to a weaker strategic focus and a higher administrative burden than might otherwise be the case. In addition, some periodic maintenance is still being classified as capital expenditure and there are concerns that externally-funded technical assistance may be being classified as capital expenditure.

8. Albania has recently introduced properly sequenced and disciplined procedures regulating the pre-implementation phase of the project cycle and linked to a hierarchical review and approval process. The procedures apply equally to all projects whether they are externally or domestically funded. Importantly, they include an identification and preliminary screening step, where consistency with policy objectives and project logic are first assessed, and a decision is taken on whether it’s worth proceeding to preparation. They also include a formal appraisal decision which focuses mainly on ascertaining whether a project is likely to offer value for public money.

9. The sophistication of project appraisal and the supporting analytical studies is made proportional to the scale, complexity and functional characteristics of the project. Economic cost benefit analysis is therefore only required for projects above a certain threshold value, which varies by
sector, as are full feasibility studies and impact assessments. There is a requirement to examine project alternatives. Basic performance parameters for later monitoring and evaluation are defined during preparation. Responsibilities for decision-making and the criteria to be used are clearly set down.

10. **The new public investment management procedures are well designed, but they suffer from a number of weaknesses in their application at the level of spending ministries.** Identification and preliminary screening is internal to ministries and is only being applied with any seriousness in a few. The quality of appraisal submissions made to the DPIM (summarized on the Investment Project Proposal Form – IPPF) is not of a sufficiently high standard yet, with frequent information gaps and CBA not being performed when required, notably for domestically funded projects. Project alternatives are also rarely considered.

11. **The DPIM is currently rejecting around 20 per cent of submissions because of poor quality and would probably reject more if not under pressure to maintain capital spending.** All the same, the procedures have only been in place for two years and some teething problems should be expected. Quality can be expected to improve gradually if the DPIM continues rejecting the worst offenders and thus builds its credibility. The limited progress in applying preliminary screening is more worrying though and it would be useful to examine ways of improving discipline in the application of this part of the procedures.

12. **Shortages of the necessary skills are partly to blame for the quality problems, but absence of demand from decision-makers for high quality analysis is also a factor.** Projects motivated by short-term political gain continue to be pushed through, damaging the credibility of the procedures. Given their new roles as ‘authorizing officers’ under the new organic budget law, the general secretaries of the spending ministries would be an obvious starting point for improving awareness of the procedures and the underlying analytical methods.

13. **Although the procedures are basically sound, further clarification of some of the analytical requirements would be valuable.** The procedures are not clear about the criteria to be used in determining whether a medium-level appraisal or full appraisal is required. It is also not apparent under what conditions cost-effectiveness analysis would be an acceptable substitute for cost-benefit analysis. Multi-criteria analysis, which can be useful in some circumstances for deciding between alternatives, is not mentioned at all. More generally, after two years of operation it would probably be worthwhile undertaking a review of the procedures, including consultation with users, to determine where improvements might be made. The value thresholds determining the sophistication of analytical requirements is one specific area that should be reviewed to ensure an appropriate match with analytical capabilities and the information needs of decision-makers.

14. **Shortages of staff and the necessary skills are preventing the DPIM from probing the justifications for major investment proposals and from taking a lead in promoting good practice.** The Department currently does little more than carry out compliance checks with respect to the procedures. It needs to be strengthened so that it can assume a more active role in public investment management that extends to performing a credible challenge function, developing methodological guidance and designing and delivering targeted training to spending ministries. Informed by an initial training needs assessment, a medium- to long-term capacity building plan therefore needs to be developed for the Department as a matter of urgency.

15. **More detailed and practical guidelines, with worked examples from different sectors, are required to make the public investment procedures more operational.** The guidance accompanying the procedures is a useful introduction to the concepts, but is unlikely to be sufficient for those not
already familiar with the methods. As an interim step, recently published guidance from the EC could be translated into Albanian, awaiting preparation of national guidance. An assessment framework and methodological guidance for PPP arrangements are also urgently needed as there is a large void in this area.

**Budgeting for Capital Investment**

16. While in theory there should be a comprehensive coverage of capital expenditure in the budget, there are still some omissions relating to expenditures funded by foreign grants. The scale of these omissions is difficult to assess, but there has been a gradual improvement in coverage and the new organic budget law now provides a firm legal basis for budget comprehensiveness. The new law also supports greater transparency in capital budgeting by requiring ministries' annual budgets to include a list of their projects supported by financial information on total estimated costs, expenditures incurred and planned future expenditure, both in the budget year and beyond.

17. The DPIM's role is to ensure that no projects can be proposed for budget funding without completing the required appraisal and receiving the necessary approvals as set out in the procedures. The system works by requiring all projects eligible to be proposed for budget funding to be given a unique identification number and to be included in an investment database, once verified by the DPIM or, for higher value projects, by the Senior Budget Management Group. Even so, the system is not yet immune to significant numbers of unplanned and politically motivated projects being pushed onto the budget at the last moment; although in these cases the necessary form-filling is still being done, even if the substance is missing.

18. The budget process is intended to be the unique route for selecting public investment projects for funding. This principle is somewhat undermined by the regular practice of introducing a supplementary budget, usually with a significant investment component, in the middle of the year. This offers an alternative entry point for new projects that have not necessarily been subjected to the same rigor as projects introduced through the annual budget process.

19. Albania’s performance-oriented budget system requires spending ministries to demonstrate that proposed projects will deliver outputs that will contribute to the achievement of the policy objectives of the expenditure program to which they belong. Program policy objectives must in turn be derived from the strategic plans for the sector. Project selection is performed by spending ministries, but their capital expenditure requests are scrutinized by the Department of Budget Analysis, Policy and Programming as part of the overall review of a ministry budget submission.

20. Capital budgeting is now framed within realistic three-year capital expenditure ceilings, set at the level of ministries and generated through the MTBP process. The MTBP is beginning to deliver greater predictability and providing a credible setting for better strategic prioritization and improved programming of public investment by spending ministries. Discipline has improved as credibility has grown and ministries select new projects for funding and budget for ongoing projects while respecting the capital ceilings.

21. There are no rigorous checks on the ‘readiness-to-go’ of projects prior to their inclusion in the budget, often meaning a substantial delay in starting projects at the beginning of the year. These checks are needed because there is a strong reluctance on the part of ministries to begin any kind of serious preparation for implementation before the allocation of approved budget funds by the MOF in January of the budget year. This causes procurement delays.
22. In practice, there is still some way to go before ministries budget seriously for the future recurrent expenditure consequences of today’s capital spending. However, the MTBP, together with its supporting infrastructure, is set up specifically to foster integrated budgeting of capital and recurrent expenditure and in time this aspect can be expected to improve as the process becomes more deeply embedded.

**Procurement and Capital Budget Implementation**

23. The Public Procurement Law (PPL) is based on recognized public procurement principles and makes open procurement the preferred procedure. While not being fully harmonized, the PPL is basically in line with the relevant EU directives. Although there remain some weaknesses, notably to do with ensuring fully independent review of appeals, the basic legislative framework for fair and efficient public procurement is in place.

24. The most important weaknesses in procurement lie in the capacities to implement the PPL. More work needs to be done to improve the professionalism of contracting authorities and to strengthen the Public Procurement Agency so that it can contribute to this by training procurement officers and provide guidance on the application of the PPL.

25. Although direct evidence is hard to come by, corruption is understood to be endemic and deep-rooted when it comes to securing works contracts. Once contracts are won, further corrupt practices, sometimes involving complicity between contractors and supervising engineers, can compromise the quality or volume of works. Part of the longer term solution lays in improving capacities to implement the PPL. Greater transparency will also be important and the recent introduction of e-procurement should help in this respect. As important, though, will be leadership from the highest levels in tackling corruption.

26. Both the new organic budget law and the PPL allow for multi-annual contracting within the scope of the annual budget. However, there remains a general reluctance among spending ministries to plan and implement outside an annual perspective when it comes to domestically funded projects. Combined with an unwillingness to plan in advance for procurement, this means that there is a continued strong tendency for execution to be skewed towards the second half of the budget year.

27. Up till now in Albania, attention has focused on improving the pre-implementation phase of the project cycle and more now needs to be done to improve the subsequent phases. In this respect, now that there are some solid procedures covering project preparation, appraisal and selection, it would be advantageous to deepen and extend these to cover subsequent phases of the project cycle, especially implementation. Improvements in treasury systems are also urgently required so that project managers (and monitoring units) can receive financial reports on individual, domestically-funded projects and on ‘programmatic’ projects consisting of consolidated groupings of similar small projects. In the longer term, the functionality of Albania’s evolving Financial Management Information System needs to be upgraded so that it becomes a useful tool for active project management.

28. There is still some way to go before an effective project monitoring system is in place in Albania. Efforts by the DPIM have so far centered on setting up procedures and testing the reporting formats. Monitoring has so far been passive. This is probably not surprising at this stage, but quite soon, once more reliable and complete information flows are established, mechanisms for more responsive monitoring will need to be set up, so that there is systematic follow-up when problems are identified. Improving financial information flows from the Treasury is also a prerequisite for better monitoring. The continuing weakness of implementation planning will be a problem for the monitoring system: in the
absence of stable and well thought out plans against which to compare performance, monitoring serves a limited purpose, except to highlight the need to improve planning.

**Evaluation and Audit of Completed Projects**

29. Evaluation and audit is the weakest phase of the PIM cycle. Apart from those demanded by donors as part of their own procedures, there are no systematic evaluations of projects upon completion. This means that strategic planning of investment and design of individual projects are not currently benefitting from the experience, both negative and positive, gained in carrying out previous projects. The DPIM is aware of the need to develop a systematic evaluation process but, probably rightly, is currently concentrating on developing and establishing systems for monitoring project implementation. Albania’s supreme audit institution is not yet active in carrying out performance audits.

**B. BOSNIA**

**Institutional Framework**

30. **Responsibility for public investment now resides in dedicated departments within the finance ministries of the State and the two entities.** Since the end of the war, most public investment in Bosnia has been externally-funded. Public investment programming and aid coordination responsibilities have thus tended to be fused, and kept more or less separate from the responsibilities of the budget planning departments of finance ministries (even to the extent of being in separate ministries at one stage). The latter has retained something of a residual role, dealing with the small amount of domestically-funded investment and co-financing obligations.

31. **Recent revisions to the State and Entity organic budget laws have made the medium-term expenditure framework a legal requirement of the budgetary process.** Budget preparation calendars are not harmonized yet though.

**Strategic Setting**

32. **Public investment management in Bosnia is handicapped by serious deficiencies in the scope and quality of the strategic guidance that is available to support investment planning and decision making.** The complex governmental structure does not favor the emergence of unified policy making and strategy development at the level of the State. The result is relatively ineffectual strategic directions coming from this level, and fragmented and uncoordinated strategy formulation at Entity-level and below.

33. **There is not much appetite for a State-wide strategic document and most of the impetus is external.** The Mid-Term Development Strategy (MTDS) was an important, but not entirely satisfactory, first attempt to develop a State-level development and poverty reduction strategy. The strategy was not properly costed or made consistent with the likely availability of resources, and it has remained a static, imperfect and largely ignored planning instrument, with weak national ownership. In anticipation of the expected EU pre-accession requirement, the BH authorities have embarked upon the development of the BH Development Strategy 2008-2013. Completion of the Strategy has, however, been delayed until the end of 2009. Even when finished, it is unlikely to have a significant bearing on strategic development decisions made at the Entity and sub-Entity levels, being a merger of mutually acceptable elements of Entity strategies. The limited human resources capacities of the Directorate for Economic Planning also handicap strategy development.
34. **Entity-level strategy development has progressed much further in the Republic of Srpska (RS) than in the Federation.** The RS Government has adopted a Development Program 2007-2010 and related Public Investment Program (updated to 2008-2011), which are set within a macro-fiscal framework. There is no real equivalent in the Federation other than a brief strategic plan of the current government.

35. **Higher level strategy development is not being accompanied by systematic sector policy and program development in either Entity.** Individual sector plans are not being developed or updated on a consistent basis by sector ministries and those sector strategies that have been prepared suffer from similar problems to the MTDS, i.e., weak or missing cost estimates, failure to prioritize and no realistic resource constraints. The traditionally weak strategic policy-making role of the ministries is a particular handicap for improving strategic investment planning.

36. **The Public Investment Programs (PIP), now being prepared at the State-, Entity- and canton-level, do not represent affordable and strategically prioritized investment plans.** Having emerged as instruments to coordinate and attract donor assistance, the PIPs continue to deal principally with externally-funded projects, although the RS PIP now has wider coverage. They bear a tenuous relationship with strategic plans, which are anyway weak, and are disconnected from budget preparation. The State-wide PIP is merely an aggregation of PIPs generated from the bottom up.

*Identification Preparation and Appraisal of Capital Investment Projects*

37. **A reasonably sound conceptual definition of what constitutes a project seems to be being used in Bosnia, but there are some ambiguities in the definition of capital expenditure that need to be resolved.** Entity finance ministries should therefore provide a clear definition of capital for budgeting purposes. A broad definition of public investment is being applied for PIPs which includes (externally-funded) institutional development projects. PIPs cannot therefore be interpreted as capital investment programs, although the appropriate distinctions seem to be being made internally.

38. **Systematic and universally applicable pre-implementation procedures have been slow to develop in Bosnia because most public investment has been externally-funded.** Externally financed projects are subject to the procedural requirements of donors and IFIs when it comes to identification, preparation and appraisal and, to an extent, this has obviated the need to set up national processes. The importance of establishing such procedures, applicable to all projects irrespective of the funding source, will grow as Entity governments become increasingly involved in financing public investment from domestic resources and as external financing reduces in importance.

39. **Some progress has already been made though, and in both the Federation and the RS, elements of a structured pre-implementation process already exist.** However, gaps in the substance and coverage of existing procedures and the uneven discipline with which they are being applied indicate that there are serious weaknesses still remaining to be addressed.

40. **The Federation MOF has set out procedures (the ‘Rulebook’) for project identification, preparation and prioritization, which apply to federal ministries, cantonal ministries and municipalities.** These procedures contain some of the basic elements for quality controlling public investment projects prior to implementation. They cover project identification, involving preliminary analysis of the project concept and logic, and project formulation, where deeper analysis of the project’s feasibility and justification is supposed to be carried out, including assessment of value for money. The results of these steps are summarized on project forms.
41. Although the Federation Rulebook has elements of good practice there are also some apparent weaknesses in its design and application:

- An over-emphasis on 'prioritization' to the detriment of prior screening steps.
- Absence of an explicit link to a decision-making process for individual projects, i.e., the decision to proceed to formulation and the appraisal decision.
- Insufficient explanation of the detailed planning and analytical work required to underpin the information asked for on forms.
- Awareness of the procedures does not seem to be widespread and their application is patchy.

42. The RS lacks a set of procedures applicable to all projects irrespective of the funding source. A set of systematic procedures has, however, been developed for projects financed through the off-budget, Economic and Social Component of the Development Program, and these include some, but not all of the elements required for systematic appraisal. Like the Federation Rulebook, specification of the analyses or studies required is not detailed enough though.

43. All the same, there remain serious weaknesses in the pre-implementation phase of the project cycle in Bosnia, the most important being:

- Short term political influences continue to play an important part in project identification.
- There is no systematic preliminary screening of project concepts to weed out poor ideas.
- Very limited use is being made of formal techniques of economic analysis, except as required by donors and IFIs, and economic efficiency is being given too low a weight in decision making.
- There are no requirements to examine alternative ways of achieving a project's objectives.
- The distinction between project screening (quality control) and project selection (the funding decision) is too blurred.

44. Capacities for preparing good projects do not seem to be a binding constraint in Bosnia. It is true that the public sector has limited capacities and difficulties in retaining staff with the right skills, but when called upon to do so the private sector can provide the necessary consultancy services to do acceptable technical design work and carry out technical and economic feasibility studies and environmental and social impact assessments.

45. Building on and extending the positive aspects of the existing processes in the Federation and the RS probably represent the most promising ways forward. The Federation Rulebook has now been in place for five years and it would therefore seem timely to undertake an in-depth review of its scope, approach and functioning, with a view to strengthening the procedures, making them more operational and improving their consistency of application. In the RS, the positive features of the procedures for projects seeking funding from the Economic and Social Component would be a good starting point for developing a preparation and appraisal process that applies to all public investment.

46. Bosnia lacks adequate methodological guidance and training on project preparation and appraisal. The absence of guidance on economic and financial analysis of investment projects is of particular concern and one option might be to translate recent EC guidance. A gradualist approach to capacity building is likely to prove the most effective in the long run. This would involve begin by building up a small core of expertise in the finance ministries first; this group would then have
responsibility for developing methodologies, disseminating guidance and organizing focused training in the spending ministries (and cantons in the Federation), starting with the big investors.

47. **It will be essential to supplement the laws on PPP arrangements currently under preparation with clear guidance for officials, supported by adequate training.** Training needs to make participants aware of the potential risks to the public finances of poorly designed PPP arrangements, including concessions, and of the need to bring in experienced outside expertise in specialist areas like contract design.

*Budgeting for Capital Investment*

48. **The majority of public investment is still externally funded and a large part of this is implemented off budget.** Budgets are therefore far from being comprehensive when it comes to capital expenditure, particularly at the Entity-level, where most of this investment is taking place. Budget comprehensiveness is also compromised by the existence of extra-budgetary social funds, although investment from these is likely to be minor, and by significant off-budget expenditure, including a large investment component, using privatization proceeds, in the RS.

49. **None of the finance ministries, at either State- or Entity-level, have well defined checks to prevent inadequately prepared and appraised project from entering the respective budgets.** Nor is it evident that the departments concerned have either the mandate or the capacities to carry out such checks. The absence of adequate safeguards means that un-validated projects responding to short-term political imperatives, can, and frequently do, enter the budgets. The extent of this problem has been limited by the large amount of externally financed (and off budget) public investment, which is automatically subject to the more stringent procedures of the donors and IFIs, but it is becoming more important. Recommendations have been made for strengthening the gate-keeping function in the public investment coordination departments in finance ministries by creating ‘investment appraisal analyst’ positions. These proposals deserve to be considered seriously.

50. **Progress has been made towards establishing a functioning medium term expenditure framework as an integral part of the budget planning process at State, Entity and canton levels.** Recent advances include integrating the MTEF and annual budget preparation calendars, so that they are no longer parallel exercises, and making ceilings more operational by setting them at the level of budget users as well as sectors. Medium-term ceilings generated through the MTEF process are included in the budget circular and now form the basis for preparing detailed annual budget requests and two-year forward estimates.

51. **Once these budgetary reforms are firmly embedded, they will provide a stronger basis for public investment management, but there remain some significant problems to be overcome first.** Limited political engagement in the MTEF - not helped by the weaknesses in strategic policy making - is the critical problem and the MTEF is still a relatively fragile process requiring external assistance to sustain it. Experience in setting and enforcing ceilings is also limited and budget users are still not very disciplined in adhering to these expenditure limits in their budget requests. In addition, the credibility of the ceilings is being undermined by informal political lobbying to influence budget allocations outside the MTEF process.

52. **The most pressing problem for capital budgeting, however, is the poor integration of the PIPs into these improving budgetary processes.** Established primarily as instruments for coordinating external assistance, PIPs have a number of disadvantages when they are developed in isolation from core budgetary processes. Among these are that they are not resource-constrained, causing them to become
closer to wish-lists than properly prioritized capital spending programs, and that they do not take account of the future recurrent cost implications of projects so that sustainability is not assured. PIPs also undermine the discipline of a unitary budgetary process by opening up another route for selecting projects for funding that is not subject to the same scrutiny as other expenditures.

53. **In response to these issues, Bosnia needs to move towards a closer integration of capital and recurrent budgeting within the evolving medium-term budget planning and annual budgeting process.** Recommendations to this effect have already been prepared and submitted in 2007 under the DFID Strengthening Public Investment Management Project (Phase II) and these now need to be considered as a matter of urgency by both Entity governments.

54. **The recommendations envisage each Entity continuing to prepare a PIP as well as a ‘consolidated capital budget’ according to a process that is aligned with the medium-term budget calendar.** PIPs would be retained as a devices for assisting communication with donors and potential donors, whereas the capital budget would be a comprehensive list of on- and off-budget capital expenditures, including capital spending by EBFs and other off-budget mechanisms, and all externally-funded projects. The capital budget would thus provide finance ministries, governments and parliaments with an annual consolidated record of all committed capital expenditure (including forward commitments for ongoing projects) by major expenditure program. In the longer-term the aim should be to move towards comprehensive and fully integrated budgets, with the PIPs becoming largely redundant instruments.

**Procurement and Capital Budget Implementation**

55. **Reasonable progress has been made in moving towards more competitive, efficient and transparent procurement in Bosnia.** This is mainly since the adoption of a BH-wide Law on Public Procurement aimed at promoting cost-effective procurement and economical use of public funds and since the setting up an independent Public Procurement Agency to ensure proper application of the law. As a sign of success, open procurement was used in 80 per cent of procurement operations by value in 2006.

56. **In spite of improvements to the legal framework and its implementation, corruption in public procurement remains a significant concern.** Worrying breaches in the application of the law have been reported by auditors in relation to some major contracts, and political involvement in contract decisions has been identified in some such cases. Reform of procurement law and practices is only part of the solution to reducing corrupt practices by making them more visible and easier to trace. Experience demonstrates that strong leadership by example from the highest levels is also required in the fight against corruption. This seems to be the area where more effort is now required.

57. **The budget legislation is rather inflexible and places limitations on contracts exceeding one year's duration.** This adds to the costs and impairs the efficiency of implementation of larger multi-year investment projects. These limitations create particular difficulties when there are delays in adopting budgets which can make it impractical to award contracts in compliance with the PPL and complete works in the same year.

58. **The institutional framework for PPP is weak and needs to be substantially improved.** PPP/concession arrangements are already being discussed and agreed, but the basis for making decisions remains highly opaque. New PPP laws are in the process of being drafted in both entities and these are badly needed.
59. The system of implementing donor-financed projects through dedicated project implementation units (PIUs) outside local administrative structures is probably now acting as a handicap to improving internal project management and accounting arrangements. Originally established in the post-war environment because of the significant weaknesses in local systems, the separation between the PIUs and the responsible line ministries or implementing agencies is now acting as a barrier to the transfer of skills and the development of local capacities. The proliferation of PIUs has now been halted, but the time has probably come to develop strategies for absorbing the existing PIUs into ministry structures. Such strategies would need to consider remuneration policies so as to avoid losing skilled personnel.

60. With the establishment of a modern and efficient treasury system, Bosnia now has reliable accounting and timely financial reporting systems in place. The treasury system is probably not yet being used to its full capacity to assist project managers in the financial management of projects though, and there is still some way to go before a fully functional financial management information system is established, although work on this is about to commence.

61. Donors remain reluctant to use Bosnia’s public financial management systems to implement their projects because of continued weaknesses in other areas such as internal financial control and internal audit. This is one of the reasons why externally-funded projects stay off budget. This is understandable, but is still an area where progress needs to be made if these projects are eventually to be brought fully on budget. This will require willingness on the part of the different governments to move forward in a coordinated way. An interim step might be to use the treasury system to record the transactions of PIUs, and matching loan or grant proceeds, even though these are being carried out outside the formal systems. In this way, externally-financed projects can begin to be reflected in the budget.

62. Systematic and responsive monitoring, whether of budget-funded or externally funded projects, is not being practiced. Any monitoring being carried out is informal and ad hoc. Ministries report that they receive regular progress reports from project implementers and monitor them, but this seems to be more in the sense of ‘keeping an eye on things’ rather than an organized monitoring process involving established procedures, systematic reporting and checking financial and physical progress against a pre-defined implementation plan.

63. A much more intensive effort is going to be required in setting up reliable monitoring systems. However, since monitoring needs to be based on monitor-able plans, its usefulness will also depend on better project preparation. Bringing externally financed projects on budget and making better use of the treasury system would be the ideal solutions to improving financial monitoring. In the absence of this, better use could be made of the Grant Resources Management System as a monitoring tool, but this demands greater State-Entity coordination than may be possible.

64. Collusion between supervising engineers and contractors during project implementation seems to be a not uncommon problem. Independent supervision of works contracts is obligatory and the system has the appearance of being objective, but anecdotal evidence suggests that this is not the case. The result is higher costs or lower quality of works than originally contracted.

**Evaluation and Audit of Completed Projects**

65. Evaluation is one of the weakest areas of the public investment management systems in Bosnia and there are, as yet, no systematic evaluation procedures at State-, Entity- or canton level. Donors have their own evaluation processes, but generally the involvement of the governments in these is as a provider of information rather than as an active participant in the evaluation process. There are no
procedures in place in any of the governments for systematically reviewing the results of donor evaluation and incorporating these into the governments’ strategic investment planning (which is anyway weak) or into the design of individual projects. As with monitoring, there is a sequencing issue in relation to improving evaluation: evaluation requires good project planning and reliable monitoring systems to be a useful activity.

C. Kosovo

Institutional Framework

66. The Ministry of Economy and Finance (MEF) has responsibility for regulating the public investment management system in Kosovo. This it does through the budget process and the process for managing the Public Investment Program (PIP) data base. Unlike other countries, the PIP is not dominated by donor-funded projects or projects seeking donor funding: it is predominantly concerned with projects funded through the budget or seeking to be funded through the budget. This makes it unusual and not necessarily subject to all the same pitfalls, e.g., dual budgeting, as PIPs elsewhere.

67. There are no specific decision-making bodies for public investment in Kosovo: investment decisions are intended to be made through the budget process. There are, however, plans to form a National Investment Committee to quality control larger projects for inclusion in the PIP. The Donor Coordination Centre has been responsible for coordinating and monitoring external assistance, but it is currently being restructured.

68. At least on paper, Kosovo has a budget process that involves an integrated calendar incorporating preparation of a medium-term expenditure framework (MTEF) and the annual budget. The organic budget law (the Law on Public Financial Management and Accountability – LPFMA) sets out a budget process that begins with the preparation of the MTEF during the first four months of the year and continues with detailed budget submissions based on the ministry MTEF plans.

Strategic Setting

69. Kosovo’s capital spending lacks strategic focus because of the absence of a well articulated set of strategic policy and program priorities at the sector level to guide public investment planning. A draft national strategy, the Kosovo Development Strategic Plan, was prepared in 2006, but was never finalized or approved. In the absence of an overarching strategic planning document, the MTEF has been used as the main instrument for setting out national and sector priorities. This is somewhat different from the usual conception of an MTEF as a tool for aligning expenditure plans with strategic priorities and macroeconomic and fiscal constraints, and not a strategic planning instrument in its own right. This reflects the stage of development of policy making in Kosovo and the recent uncertainties faced. In spite of the absence of more broadly based plans, strategic investment plans have been developed in some sectors and some locations using rigorous prioritization methods, notably for road transport, for schools and for infrastructure in the Municipality of Pristina.

70. The MTEF has been an important reference document for informing development partners of Kosovo’s strategic priorities. The 2009-2011 MTEF was prepared with the July 2008 Donor Conference as its focus and prior to that the 2006-2008 MTEF was aimed towards the donor community.
Identification, Preparation and Appraisal of Capital Investment Projects

71. A rather narrow concept of what constitutes a ‘project’ and a low minimum threshold (€1,000) for expenditure to be classified as capital mean that there are too many small projects in Kosovo. A substantial number of these are for small equipment purchases that are being treated as capital projects. Others are very similar, small projects or integral parts of a single, larger asset. Officials report that the system can cope with the additional administrative burden of many small projects, but there is inevitably a loss of strategic focus and performance-orientation in decision-making. Grouping similar, small projects into consolidated programmatic projects could simplify the planning and decision-making process and lead to a more coherent investment process. An increased focus on the purpose of a project, i.e., delivery of sustainable benefits to the target group, could help in better defining a project’s scope. In other respects, the accounting definition of capital spending being used is consistent with international practice.

72. A strengthened PIP process has been designed to bring more structure and analytical rigor to the pre-implementation phase of the project cycle. The usefulness for decision-making of the project data being requested has improved and the filtering process for capital project submissions has been enhanced. A two-step process has recently been introduced, requiring projects with a total value in excess of €400,000 to undergo more rigorous pre-implementation assessments, including cost-benefit analysis. Once prepared, these large projects will then be submitted to the planned National Investment Committee for review and approval (or return to ministries for further work). There is an incentive to use the procedures because only projects that are included in the PIP are now supposed to be eligible for budget funding.

73. There is still a wide variation among budget organizations in their internal arrangements for analyzing and preparing projects prior to implementation, in spite of these PIP-related improvements. A few ministries, such as Transport and Education, have more systematic internal procedures and use more rigorous approaches for identification, preliminary screening and preparation of projects and for subsequent prioritization in line with sector policies. The majority of ministries still have weak systems in place, leading to poorly conceived projects being promoted with little or no analytical basis or clearly argued justification.

74. The intended discipline of the PIP procedures is not yet being achieved and their application is still very uneven. Introduction of the two-step process for project preparation and review was delayed until 2009 and the results are therefore yet to be seen, but are expected to be positive. Up until now, quality control of PIP approved projects has been poor: projects in the PIP system have been found to have significant data deficiencies in around 50 per cent of cases.

75. Significant further efforts are required to strengthen the design and application of pre-implementation procedures in Kosovo. There is still a clear tendency for projects across the public sector to be submitted for decision making without a thorough assessment of whether they offer good value for public money and without assurance that major risks and potential impediments to implementation have been adequately addressed. There is some qualitative assessment of the balance between costs and benefits for larger projects, but there is very limited use of sophisticated quantitative project appraisal techniques such as cost-benefit analysis. Within most ministries, there is a severe shortage of staff with the necessary understanding of these kinds of techniques and further well targeted and practical training linked to PIP requirements is required.

76. Firmly embedding the application of the two-step preparation and review process will be one important way forward. The value threshold for more sophisticated analysis should be increased if
necessary to make best use of scarce analytical skills and make sure that good quality assessments are being undertaken for the highest value projects. Some flexibility on the analytical methods for larger projects needs to be retained: economic cost-benefit analysis is not always possible or sensible, and cost-effectiveness analysis or multi-criteria analysis might sometimes be more appropriate tools, where benefits are difficult or costly to quantify in monetary terms.

77. The introduction of a formal preliminary screening and approval step in the project cycle needs to be considered seriously. This would ensure that poor project ideas are ‘killed off’ early on and that resources are not wasted on preparing projects that are inconsistent with policy priorities or have no chance of being financed. The danger with the current system is that a lot of scarce financial and analytical resources could be wasted: either on detailed preparation of higher value projects that are subsequently rejected for inclusion in the PIP; or on stacking the PIP with apparently sound projects that have only a remote possibility of being financed. Both of these possibilities could be avoided through initial screening and approval of project concepts for full preparation (and forward programming in the outer years of the MTEF).

78. A comprehensive manual for the PIP process has been prepared, and is being updated to incorporate recent refinements. The PIP manual is available on the internet. No guidelines for planning and evaluating PPP arrangements have yet been developed.

Budgeting for Capital Investment

79. The comprehensiveness of Kosovo’s budget is compromised because donor-funded capital (and other) projects are not being captured. It is difficult to obtain recent estimates of the scale of this expenditure, which had become small by 2006, but it is likely to grow with Kosovo’s change of status. If the latter is expected to be the case, then a more integrated budgeting process needs to be developed urgently to reflect this assistance accurately in the budget alongside other capital expenditure and recurrent expenditure.

80. Explicit recognition of the full cost of multi-year projects and of expected expenditures beyond the budget year is a requirement of capital budgeting, but is not yet being fully satisfied. This information forms part of the capital expenditure plan required by the LPFMA as supplementary information to the budget. The plan must give details of the total cost of each project and the cost for each year during which the project is implemented. Few ministries have been providing the required capital expenditure plan. Partly this reflects the fact that capital budgeting is still concerned with the financing of a multitude of small annual projects that lack strategic focus.

81. The Ministry of Economy and Finance has not been performing an effective ‘gate-keeping’ role by blocking projects that are not in the PIP from entering the budget. As a result, the majority of projects in ministry budget submissions has been found not to have followed PIP procedures and is inadequately prepared as a consequence. Weak capacities in the MEF to manage the process are partly to blame, but there has also been a lack of willingness at the political level to adhere to Cabinet-agreed processes: it is difficult for officials to resist this kind of pressure. Some tightening up of checks is planned for 2009 as part of the ongoing improvements to the PIP process.

82. Checks on implementation readiness are also not being performed prior to budget approval resulting in delays in execution. Lack of detailed technical designs, incomplete land expropriation or missing procurement plans are the kinds of problems that are delaying implementation. Strengthened procedures in this area would assist in improving the efficiency of capital budget execution.
83. On paper, Kosovo has a well designed budget preparation process that ought to be conducive to good public investment management. The MTEF, which is prepared at the beginning of the year and approved at the political level, sets out the resource limits and strategic orientation for the annual budget and the medium term, including expenditure ceilings for the next three years. The budget circular requires budget organizations to prepare their budgets in line with the MTEF ceilings, making sure that their medium-term expenditure proposals for capital investment projects are prioritized to remain within their allocated capital expenditure ceilings. The budget is intended to be the primary vehicle for deciding on capital investment that will be financed during the budget year. In theory, this should create a stable and predictable setting for public investment management.

84. In reality, the budget process suffers from a number of problems, a lack of alignment between the MTEF and the annual budget being one of the most serious. The MTEF is still not integrated into the annual budget process and to date they have been largely parallel exercises. The 2009-2011 MTEF, for example, was finalized too late to inform the budget circular and therefore to form the basis for ministry budget submissions. Like previous MTEFs, it was also prepared with a primary focus on outlining external funding needs for the Donor Conference, indicating some degree of confusion concerning the role of an MTEF in budgeting. 2009 is therefore likely to be the first real test of the MTEF as a basis for fiscal strategy formulation and budget preparation.

85. The actual conduct of budget preparation diverges considerably from the process as designed. It has tended to be based on low quality data and poor explanation for budget proposals. It involves extensive negotiations between ministers outside the formal discussion of budget submissions and frequent circumvention of the formal process. Most budget decisions are made in the last two months of budget preparation and often do not relate to the content of budget submissions. Only a minority of capital expenditure proposals considered during budget preparation have been adequately prepared in the PIP system and often the selection changes considerably after the budget has been approved.

86. The PIP is also not sufficiently aligned with the budget preparation process and, in particular, with the MTEF. As a result, the PIP risks becoming an overloaded wish-list, rather than being a potentially useful strategic investment planning tool, because it is not constrained by any realistic assessment of resource availability. While there is, for purely technical reasons, some advantage to having a project pipeline with a funding requirement marginally in excess of what is expected to be available, top-down discipline still needs to be applied to avoid the PIP becoming a repository of good, but unaffordable ideas. PIP preparation therefore needs to be coordinated with the MTEF, sharing a common macroeconomic and fiscal framework.

87. The mid-year budget review process provides substantial scope for significant adjustments to the capital budget including the introduction of new projects. This could be seen as undermining the annual budget process and failing to create a good environment for improving the planning of individual projects and of the capital budget as a whole. A balance needs to be achieved between allowing sufficient flexibility for efficient and effective capital budget execution and creating the right incentives for good project planning. At the moment in Kosovo, the balance is probably not sufficiently in favor of the latter: the large revisions possible under the mid-year budget review, combined with the flexibility budget organizations already have for reallocations, mean that poor planning is not being penalized since adjustments can always be made later.
Procurement and Capital Budget Implementation

88. The 2007 Public Procurement Law (PPL) represents an important step in the right direction towards competitive, efficient and transparent procurement of works contracts. Open procurement accounted for 77 percent of all procurement by contract value in 2008. To achieve full compliance with international good practice, further work is required in the areas of competitive dialogue, electronic procurement, framework agreements, criteria for selection and contract award criteria.

89. Both the LPFMA and the PPL allow multi-year contracting. Contracts made under these arrangements must incorporate clauses into contracts that limit financial commitments to funds authorized by the Assembly in the annual budget appropriations. In spite of the scope allowed by the laws, the tendency is still to plan and implement single-year capital projects, even when larger multi-year projects might be possible. This leads to a bunching of small procurement operations taking place in the first part of the financial year. The failure to design and implement larger projects, where this is possible, leads to administrative inefficiencies and higher total investment costs.

90. Many budget organizations see procurement arrangements as a major source of delay for projects. A particular concern arises where there are less than three responsive tenders because extra time is then needed to obtain approval from the Public Procurement Agency for use of negotiated procedures. The small Kosovo market makes this problem even more prevalent here than it might be in other jurisdictions where larger populations and more established providers increase the range of competitors. On the other hand, the tender periods specified in the legislation are not excessive by international standards and a significant part of the problem lies with budget organizations' failure to plan properly for procurement and implementation.

91. Public investment management benefits from the strong financial management systems in place in Kosovo. These provide a strong control and reporting framework for all transactions. All expenditure transactions relating to budget funds are performed using the central Treasury Free Balance system. Ministries have direct access to the system and are able to enter their commitments, payment requests, and transaction records and to prepare reports, subject to their access permissions. The Free Balance system contains very detailed information and reports can be produced with very little delay at the project level. All payments for budget expenditure are processed by the Treasury based on sound internal control arrangements. No organization is permitted to spend above funds appropriated by the Assembly.

92. Project monitoring by the MEF is limited to financial monitoring through the mid-year budget review arrangements. These arrangements do not involve detailed assessments of project progress and performance, being focused on expenditure according to budget appropriations. Where there are major deviations between budget appropriations, cash flow forecasts and actual expenditure, the MEF may recommend to Cabinet that low-disbursing projects be reviewed and funds reallocated elsewhere.

93. The Free Balance system offers the opportunity for much more regular financial monitoring but is not being fully exploited. The PIP is intended to be a monitoring tool, but information collection is not regular and it cannot meet the requirements for in-year monitoring. The possibility of feeding information from the Free Balance system into the PIP seems like an option worth exploring and is expected to be considered as part of the next phase of support for MEF systems development from the European Commission.
Approaches to and quality of project management and monitoring by budget organizations vary considerably. In spite of the emphasis given to good project management arrangements in the PIP procedures, the quality of project management arrangements and application is highly variable across budget organizations. In some cases, there is active project monitoring through internal committees and project management teams; in others, the management is limited to project teams with limited reporting to senior management on progress during the year. In terms of technology, investment-intensive ministries like Transport have sophisticated project management IT systems in place for monitoring, while other organizations with a few, small capital projects rely on spreadsheets.

Evaluation and Audit of Completed Projects

There are no standard procedures for evaluation and auditing of projects and these areas of the PIM cycle are not very well developed in Kosovo. The Office of the Auditor General is mandated to carry out performance audits, but has made little progress in this direction so far.

D. MACEDONIA

Institutional Framework

Macedonia has developed an integrated strategic planning and budgeting process governed by a common calendar. Continuous efforts have been made over a number of years to introduce strategic planning into government decision-making and resource allocation. Ministries must produce updated strategic plans and medium-term investment plans (‘plans of development programs’) at the same time as they are preparing their budget proposals and all should be aligned with the Government’s earlier defined strategic priorities. The General Secretariat of the Government and the Ministry of Finance are responsible for coordinating the strategic planning and budgeting processes and ensuring their harmonization.

The MOF has a limited overall responsibility in public investment, which it is not executing very effectively. Planning, decision-making and implementation of public investment is decentralized to line ministries. The MOF is supposed to exercise a coordination role through its chair of the committee guiding preparation of the National Development Plan (NDP) and through the Public Investment Unit, within the Budget Department. The role of the Public Investment Unit has so far been confined to an administrative one of maintaining the database for the Public Investment Program (PIP) and it does not perform a very active coordination role in public investment management.

The Organic Budget Law embodies the general principles of economy, efficiency, effectiveness and budget comprehensiveness, as well as a budget preparation process that is consistent with international good practice. Amendments made in 2005 set out requirements for: integrated strategic planning and budgeting, including a calendar; medium-term macroeconomic and fiscal forecasts as a basis for budgeting; and budget planning ceilings. Macedonia now has a program-based budget (PBB) process and the plans of development programs – ‘medium-term reviews of programs aimed at development investments’ - are a component.

Although on paper the budget preparation process appears sound it still does not seem to be translating into a well performing budget. The extent to which strategic priorities reflect the objectives of the country, and the extent to which these priorities are being turned into actual government programs are still questionable. In addition, poor implementation planning is resulting in problems with budget execution.
A high-level Strategic Investment Committee has been formed to improve strategic prioritization of investment expenditures. Chaired by the Prime Minister and including key ministers and directors of important institutions, the Committee is an improvement on previous ineffective prioritization arrangements, but it seems unlikely to be a sustainable solution as it is disconnected from existing institutional arrangements and it is unclear how it is coordinated with the other strategic initiative across government.

Strategic Setting

There is no single overarching strategic planning document guiding expenditure decision making, but a collection of documents which shape the strategic priorities of the government. Mostly these are oriented towards EU accession, including the Pre-Accession Economic Program (PEP), the NDP, the National Plan for the Adoption of the Acquis (NPAA), the European Partnership and the Stabilization and Association Agreement. The most relevant of these for public investment is the NDP.

The NDP represents a good step forward in providing sound strategic guidance to the public investment process. It is a coherent three-year framework setting out investments that are consistent with overall national development goals and that will be jointly financed by foreign and domestic public resources. The main drawback with the NDP, and with the other national planning documents, is relatively weak government ownership. The first NDP was developed in 2007 with UNDP support, but a subsequent annual update has yet to be endorsed by the Government.

In spite of improvements in system design and in strategy formulation, the strategic setting for public investment (and for public expenditure as a whole) still appears to be suffering from weak coordination. As a result, the actual impact of the various national and ministry strategies on guiding investment decision-making is questionable. The General Secretariat and the Ministry of Finance have not been succeeding in adequately coordinating the strategic planning and budgeting processes, and because of this the two are tending to run in parallel, resulting in inconsistencies between plans and expenditure decisions. Coordination between planning and budgeting within line ministries is also often poor, with the same result.

The recently introduced Plans for Development Programs could help improve the strategic guidance for public investment management. The drafting of these plans and their approval by the Government during the budget preparation process should ensure that proposed capital spending is in line with the Government priorities and fully integrated into the budget process. However, given that these changes were only recently introduced, it is too early to assess their effectiveness.

The PIP prepared by the Public Investment Unit appears to have limited usefulness. It is a database with basic information on projects at various degrees of preparation that have been considered by Government. The PIP covers a mix of projects with assured funding, including recently agreed financing through concessions and PPPs, as well as projects seeking funding, including projects which do not appear to be of the highest priority. Although there is now a correspondence between the first year of the PIP and the annual budget, the outer years still constitute more of an extended wish list. It does not appear, therefore, that the PIP is currently fulfilling a particularly useful function as an instrument for improving the strategic focus of the investment program. As a consequence, the position of the PIP within the evolving strategic planning and budgeting framework (NDP, PBB, etc.) needs urgently to be reviewed so that it can perform a useful function or be abandoned.

A number of past efforts to improve donor coordination have been disappointing and the process is currently being revamped with the introduction of a Program Based Approach (PBA) to donor coordination being introduced. The new PBA will represent a clear change in the way external
assistance is managed in the country by introducing coordinated donor support for a nationally owned program of development. In the past donors have been reluctant to use national systems and fully integrate their transactions into the budget process and it is hoped that this can be reversed.

107. **Macedonia's track record in mobilizing private financing for public infrastructure is very poor.** The experience with concessions, PPPs and private creditor financing is very limited and largely unsuccessful. A number of projects in the energy sector have already been delayed for a several years or were actually cancelled, typically because of problems with project design and the procurement process. The framework for PPPs is rudimentary and the new law on concessions/PPPs was identified by SIGMA as a particular source of concern since it has a number of significant inconsistencies with good international practice. These inconsistencies centre on the definitional differences, contract design and legal remedies.

**Identification Preparation and Appraisal of Capital Investment Projects**

108. **Within the scope of the PBB, ‘development programs’ are now being used as the main unit of analysis for public investment planning and decision-making purposes.** This means that major, multi-year infrastructure investments are being classified under a single program (effectively a traditional project), while general programs group together multiple smaller investments with common objectives (sometimes termed ‘programmatic’ projects elsewhere). This approach is well suited to ensuring that projects are properly scoped for the achievement of specific policy objectives. It represents a sensible break with the more conventional focus on investment ‘objects’ as the basic unit of analysis (which is also common in the region). For the purposes of greater procedural simplicity in the budget process, a minimum threshold of just over €16,000 has been set for spending to be treated as a development program. This is consistent with international advice.

109. **Pre-implementation procedures and decision making are weak when it comes to deciding whether a project proposal represents a good use of public money.** There are no clearly prescribed procedures or supporting methodological guidelines on the requirements of project preparation from the perspective of assessing value for money and wider impacts. Use of cost-benefit analysis is limited to a small number of projects, and proper project appraisal is only done for foreign financed projects. Projects are proposed and prepared by the initiating entity with little external oversight. The Ministry of Finance is largely interested in the narrow financial aspects of the proposed project, while the General Secretariat does not have the capacity to technically evaluate and assess projects.

110. **Technical and engineering aspects of project preparation are highly regulated through the Law on Construction.** This sets out a sequence of design steps and related approvals necessary before a project can be implemented. The licensing and permits process can be very cumbersome and a source of significant delay and additional costs.

111. **The Plans for Development Programs and the NDP, once fully implemented, could contribute to alleviating these problems.** The Plans for Development Programs are prepared by budget users but adopted by the Government. These procedures can be used to ensure proper sequencing and disciplined procedures for identification, preparation and appraisal of projects. Similarly, the implementation of the NDP will require that projects are properly prepared prior to being considered for financing.

112. **Efforts to improve identification and preliminary screening of projects are being made through the NDP preparation process.** The NDP only considers projects for which the project preparation documentation has been elaborated to a level that would enable at least a very broad assessment of the project. In addition, further screening criteria are intended to be applied to ensure a
project proposal fits with national and sector policy objectives, and is likely to offer value for money and be financially sustainable.

113. **Independent peer review of appraisal results is rare.** The concept is not completely alien though as the Law on Construction already requires engineering designs to be independently reviewed. Extending this to a broader review to take in relevance, value-for-money and other factors would be a desirable next step.

**Budgeting for Capital Investment**

114. **The Macedonian budget is comprehensive in its coverage, the only weakness being the recording of expenditures on some grant-financed projects.** Some of the main donors are still reluctant to use national systems for recording transactions and alternative means of collecting information have not been developed. Mostly this concerns capacity-building activities, but there is some capital spending, particularly on rehabilitation. Some improvement is expected soon through assistance funded under the EU’s Instrument for Pre-Accession which will use the decentralized implementation system (DIS). Even for those foreign-financed capital expenditures that are captured in the budget, the budgeted figures are unreliable because of general weaknesses in disbursement forecasting (figures on actual spending are reliable though).

115. **Information on the full expenditure implications of development projects, broken down by year and source of funds must be provided in the plans for development program as part of the budget process.** There is therefore transparency concerning the future cost implications of multi-year projects and over any year-on-year increases in total project costs. This gives decision-makers the opportunity to react to likely cost over-runs and to verify that priority is being given to completing ongoing projects before starting new ones. It is not clear if the future operating and maintenance costs of projects, once completed, are being exposed through the budget process.

116. **Currently, there is no effective gate-keeper in the system to ensure that only projects that have been properly prepared and screened beforehand can enter the budget.** The Public Investment Unit in the Ministry of Finance is not performing this function which is anyway made more difficult by the absence of formalized preparation procedures. As a result, a significant number of unsubstantiated projects, which are driven by short-term political motives, still enter the budget.

117. **The plans for development programs and the NDP, once fully implemented, could form a basis for a stronger gate-keeping function.** The NDP has a relatively clear set of criteria for inclusion and identification of projects but unfortunately is not yet integrated well with the budget process. The requirement for Government approval of plans for development programs as part of the budget process can ensure that proposed investments are linked to NDP and strategic priorities are well prepared and properly costed. Scrutiny of these plans prior to Government approval would seem to be a useful role for the Public Investment Unit.

118. **The budget is being prepared within a basic medium term perspective, incorporating ceilings on expenditures that are realistic and generally being respected.** So that they are more operational, the ceilings are set by function and by first-line budget holder. At present no distinction is made between capital and current spending, but consideration is being given to capital ceilings as a means of pushing up the relatively low overall level of capital spending. On the other hand, such an approach could introduce rigidities into the budgetary process that would not necessarily be compatible with the PBB.
119. Once it is more firmly embedded, the medium-term budget planning process has the potential to provide a more stable and predictable environment for ministries to plan and program public investment spending, but further improvements will be required. These include increased transparency in the preparation and approval stages and the introduction of a more elaborate medium-term planning framework. Mechanisms for prioritization of spending are still rudimentary and new spending proposals are not adequately scrutinized resulting in questionable programs being financed. Capital expenditures are especially vulnerable in this respect. Scarce funds are spread among an excessive number of programs probably in an effort to satisfy everybody due to excessive bargaining and conflict avoidance within Government.

120. The credibility and discipline of the annual budget process as a whole, and as the unique entry point for new projects, are undermined by frequent and significant intra-year amendments to the budget. On average there have been two major amendments per year over the 2006-2008 period. These supplementary budgets allow new projects to be selected for funding without having been through the same degree of scrutiny as other projects. This weakens incentives for improved investment planning. Expectations of upward adjustments in spending during the year, also damages the credibility of the initial ceiling setting process.

121. There are no rigorous checks of the implementation readiness of projects prior to their inclusion in the budget. The need for these checks is clear from the large number of ill-prepared projects that are entering implementation. Some of the most frequently cited problems include poor project design, incomplete preparation (such as unfinished expropriation works) as well as procurement delays. As a consequence, project implementation is often delayed.

Procurement and Capital Budget Implementation

122. The legal framework for public procurement has improved considerably since the introduction of the new Public Procurement Law in 2007 but implementation remains an issue and allegations of corruption remain a concern. The new law is nearly in full compliance with EC directives and is a positive step towards establishing an open and efficient public procurement system. There have been concerted efforts to train officials in the application of the law, standardized contract and tender documents have been prepared and information is increasingly available on-line. In spite of these efforts, some weaknesses still remain including an overly formalistic application of the procedures and a poorly functioning appeals process.

123. Both the Budget Law and the Public Procurement Law provide scope for multi-annual contracting within the scope of the annual budget. However, the links with the budget process appear to be weak in some cases. The Commitments Module of the Single Treasury Account does ensure that commitments are recorded in advance, but procurement plans are not necessarily matched with budgetary allocations before expenses are committed.

124. Project management arrangements vary in quality across the public administration and according to funding source. Some institutions have relatively sound project management arrangements, while in others these arrangements are rudimentary. As a result, there is variation in the quality of the results from government investments. It is generally accepted the foreign-financed projects have better project management arrangements because of the more stringent requirements of financiers as well as greater capability to pay for the necessary systems. However, this can also add to the problems by creating parallel structures and failing to contribute to the development of capacity in local institutions.
125. Project accounting and cost control system are sound. The budget classification and chart of accounts include individual project codes so that, it is possible to track expenditures on the projects approved for budget funding. At the same time, the Single Treasury Account provides relevant and accurate reports on spending at program and sub-program levels. Again, information on donor financed projects which are not covered by the Budget is more difficult to track.

126. A framework for active monitoring is in place, but in practice the process is not well institutionalized and lacks depth. As part of the strategic budgeting process, regular reporting on implementation of strategic priorities is required. Unfortunately, the usefulness of this process is limited because the monitoring indicators submitted during budget preparation are not always meaningful. More specifically in relation to capital expenditures, the Public Investment Unit prepares quarterly reports on the execution of budgeted capital expenditures. One of the weaknesses is that these reports only provide aggregate information on capital expenditure execution based on Treasury reports and do not give information on physical progress, identification of implementation problems and proposed solutions.

127. The project monitoring system still needs further improvement. Firstly, efforts to establish more reliable and complete information flows will need to be completed and then more responsive monitoring will need to be set up, so that there is systematic follow-up when problems are identified. The continuing weaknesses in implementation planning will remain a problem for the usefulness of the monitoring system, since it needs to be comparing reported achievements to good initial plans.

128. Asset registers exist, but the formal handover of completed works contracts is frequently not being recorded. Independent supervision of works contracts is a requirement and the supervising engineer must verify satisfactory completion of works before a use permit is issued and the formal handover can take place.

Evaluation and Audit of Completed Projects

129. Evaluation and audit is gradually developing in Macedonia. The Ministry of Finance, through its Public Internal and Financial Control Department, has overall responsibility for the development of the internal audit function. PIFC units have now been established in most government agencies; however, their effectiveness still appears to be limited by the fact that there are only a few auditors who have only basic training. The State Audit Office performs reasonable audits of financial statements and has recently introduced, on a pilot basis, performance audits. Still, a major problem with the functioning of the SAO has been the non-responsiveness of the executive to the findings of its reports and the inability to ensure follow-up.

E. Montenegro

Institutional Framework

130. The Ministry of Finance has full responsibility over current and capital budgeting, but is not yet practicing fully integrated budgeting internally. The Sector for Budget has responsibility for coordinating budgeting of capital and current expenditure, but divides the work between two units, one for current and one for capital. Neither unit is well resourced, but the investment unit is particularly short of appropriately qualified staff.

131. In response to a general lack of capacity in the administration to prepare and implement investment projects, the government has opted for a centralized system of public investment management, instead of delegating to sector ministries. This has involved planning, managing and
realizing most projects financed from the central budget through two directorates: the Directorate for Public Works, under the Ministry of Economic Development; and the Directorate for Roads, under the Ministry for Maritime Affairs, Transportation and Telecommunications. In 2009, a Directorate for Railway Infrastructure was also created. These three 'investment directorates' are responsible for preparation, procurement and implementation. Having a single unit responsible for public works is a pragmatic approach for a small country, but carries with it the risk of a fragmenting the planning of current and capital spending for individual sector expenditure programs and diluting accountability for program performance.

132. **There are no decision-making bodies specifically for public investment at the political level in Montenegro.** The Government's Committee for Economic Policy reviews and approves budget proposals for both current and capital spending. Similarly, the parliamentary Committee for the Economic and Financial System scrutinizes the whole budget proposal. This is consistent with an integrated approach to budgetary decision making.

133. **The organic budget law (OBL) has a requirement for an MTEF as part of the budget process.** There is an integrated calendar for MTEF and annual budget preparation. The OBL does not make specific reference to the principles of economy, efficiency and effectiveness in the use of public resources. This is disadvantageous for the establishment of a sound project appraisal system.

**Strategic Setting**

134. **Montenegro has no overarching national strategy to guide public investment but it does have a significant number of recently elaborated medium- and long-term sector and cross-cutting strategies that should be serving as a reasonably satisfactory basis for project identification and prioritization.** This includes strategies for the major infrastructure sectors. The problem with this approach is that these strategies have been drawn up independently, with no clear horizontal coordination, and without a consistent view of the availability of resources and their inter-sectoral allocation, raising some questions about their realism. Missing or out of date urban and spatial plans are also problem for project identification, planning and prioritization. The new Law on Spatial Planning and Building of Objects requires spatial plans to be updated and will assist in rectifying this problem if properly implemented.

135. **There is recognition in government of the need for a more comprehensive national investment strategy.** This needs to be carefully thought out though, so as to ensure an integrated approach to strategy formulation that takes account of the interdependencies between current and investment spending and is set within a coherent overall framework for expenditure. An investment strategy that is derived from a broader national strategy development process would seem to be the best way forward, possibly building on the presently stalled Agenda for Economic Reform.

**Identification Preparation and Appraisal of Capital Investment Projects**

136. The 'investment maintenance' classification in use in Montenegro seems to be a hybrid economic category which is not necessarily consistent with international practice. Investment maintenance is classified as a capital expenditure, but seems to include both periodic maintenance (generally classified as current spending) and rehabilitation (generally classified as capital spending). A clearer distinction between capital and current therefore seems to be required with some unambiguous rules for making decisions in grey areas.

137. **So as not to burden the PIM system with small value equipment purchases, only expenditures in excess of euro 25,000 are classified as capital.** This represents a sensible and
pragmatic distinction consistent with the application of the principle of materiality to budgeting. Capital assets are also defined as having useful lives of greater than five years; the usual criterion is a life greater than one year.

138. By defining value thresholds below which planning, decision-making and implementation are left in the hands of lower order budget organizations, Montenegro has tried to ensure that the three 'investment directorates' focus on the planning and preparation of larger and more complex projects. The system has not been entirely effective though because lower order budget organizations have been exercising their right to opt for the investment directorates to plan and implement even lower value projects because they themselves lack the necessary capacities. There is therefore an evident need to improve capacities to plan and implement small investments in budget organizations.

139. Montenegro has been successful in imposing a disciplined, performance-oriented definition of what constitutes a project. Investments must represent a 'functional ensemble', i.e., there is no splitting of project components into separate projects, and multi-year projects are well planned, i.e., not split into inefficient annualized projects, although phasing is used in a sensible way. The grouping of very similar small projects into larger programmatic projects is encouraged.

140. Project identification is not subject to a systematic process. It is mainly done in response to ad hoc requests or on the basis of not particularly rigorous demand surveys carried out by ministries. While there are a number of strategic plans that could form the basis for more systematic project identification, the link between these plans and project proposals is often tenuous. Although there is a requirement for project concepts to be in line with sector strategies (and for such sector strategies to be elaborated in the first place), this condition is only loosely enforced. There is no formalized preliminary screening process by which projects with the potential to offer good value for public money are identified for further preparatory work and poor project ideas are dropped.

141. Project preparation activities and procedures are not set down in a systematic and unified way in Montenegro and there are no specific requirements for cost-benefit analysis to be performed as part of a feasibility studies. Elements of project preparation requirements are set out in different places. Unusually, the Law on Public Procurement is one of the main instruments, requiring feasibility studies to be prepared and adopted, together with supporting documentation, before a project is proposed for financing. The Technical Instructions for Preparation of the Capital Budget reiterate this requirement, which applies to all capital investments no matter what the size, although this provision is ignored for smaller projects. The Law on Spatial Planning and Building of Objects lays down requirements for technical documentation at different stages of preparation. It also sets out a construction approval process, but this relates purely to technical feasibility and conformity with spatial plans and has no value-for-money perspective.

142. The existing requirements for preparation of feasibility studies prior to funding approval are neither being respected nor rigorously enforced, even for larger projects. Often feasibility studies are not prepared until after projects have been selected for financing and often it is only the more costly projects for which feasibility studies are prepared. CBA is generally not being carried out. One of the impediments is the cost of preparing feasibility studies, as well as the limited human capacities. This situation strongly supports the idea of introducing a formal identification/preliminary screening step at which point a decision is taken as to whether it is worthwhile moving to detailed preparation activities or not. Linking this step to a functioning MTEF process would ensure that detailed preparation is properly budgeted and that implementation is programmed to coincide with the opening up of adequate fiscal space.
143. A new decree is being elaborated that sets out project preparation requirements, including CBA, in a much more systematic way and makes these proportionate to project value. The proposed proportionality is pragmatic and suited to capacities in Montenegro: full feasibility studies would only be required for projects valued above €5.0 million and CBA would only be a required for projects above €15.0 million. The decree would replace the Technical Instructions and would have the advantage of separating the project preparation process from the budget cycle with which it need not necessarily be synchronized.

144. The proposed decree seems like a potentially positive development and, depending on the details, offers the opportunity to introduce a harmonized pre-implementation phase to the project cycle. In order to be effective, it needs to include formal appraisal and decision-making steps. The decree also offers the opportunity to introduce identification and preliminary screening steps and this should be seriously considered. An identification step might also be an opportunity to undertake a basic assessment ('appraisal lite') of projects with a value less than €5.0 million, which would not then be subject to further assessment.

145. There is no independent peer review of projects to verify value for money. The Law on Spatial Planning and Building of Objects stipulates the need for independent reviews of technical documentation, but this does not extend to reviewing whether a project represents a good use of public monies. This could be a valuable amendment to the law.

146. Methodological guidance on project analysis techniques exists, but it has not been officially adopted or disseminated. As early as 2002, a ‘Handbook for the Economic Analysis of Public Investment Projects’ was produced with external assistance, but it was delivered to the Secretariat for Development, which has subsequently failed to make use of this potentially useful resource. The same is true of the ‘Manual on Project Cycle Management and Logical Framework Analysis’ produced at the same time. As a matter of urgency, these guidelines need to be reviewed and officially released, preferably through the Ministry of Finance. This should be timed to coincide with the new decree on project preparation activities. Training in the application of the approaches set out in the handbook should then follow. This should initially be aimed at a small core of experts in the MOF and in the investment directorates so that a solid body of expertise is developed.

**Budgeting for Capital Investment**

147. The budget is comprehensive in its coverage of domestically-funded capital spending, but less successful in capturing externally-funded capital investment. From 2009, foreign financed projects are properly presented in the budget, but the quality of information on foreign loans is considerably better than for donor grants, for which there is very little data coming from beneficiary budget organizations and no system for collecting it, although one has been designed but never implemented. Grant-financed capital investment is, however, a relatively small share of the total, the majority of grants being for technical assistance (which is another issue). Until recently, there has been tight control of loan funds, with budget organizations only being able to spend the sums appropriated in the state budget. This has offered a strong incentive for good planning.

148. In presentation, the budget is unitary but, in practice, current and capital budgeting follow parallel tracks. This is likely to be leading to some disadvantages in terms of the balance between current and capital spending and in terms of budgeting for the maintenance and operation of new capital assets. The situation is encouraged by the separation of functions within the Sector for Budget and by focusing investment planning and decision making in the ‘investment directorates’.
149. **Detailed information on the forward expenditure implications of investment projects does not accompany the annual budget, but is required for the Budget Memorandum.** The information accompanying the Budget Memorandum must include, amongst other details, the implementation period and the total cost of each proposed project, together with the allocation of expenditures by year. Estimates of the future recurrent expenditure implications of capital spending must also be provided. This is valuable information for efficient investment programming and integrated budgeting of current and capital spending. From both these perspectives and from the perspective of improving transparency, it would be better if the same information were also provided with the annual budget. It would also provide a basis for tighter control of total project costs for multi-year projects, by ensuring that all cost increases are agreed in a transparent fashion through the budget process.

150. **Montenegro is still a long way from having a credible MTEF process that could provide a sound basis for investment programming.** The top-down discipline of an MTEF is not being achieved and ceiling-setting is not yet fully operationalized through expenditure limits at the level of budget organization. Expenditure figures in the MTEF are still being viewed as closer to indicative projections than as firm expenditure limits, and are therefore not being respected as such. MTEF expenditure figures for the outer years are still very poor predictors of actual budget allocations in those future years, further damaging credibility. Improvements in capital budget planning could obviously help in improving the realism and credibility of capital expenditure ceilings, but some initial improvements in the MTEF will be required first to launch such a mutually reinforcing process, including stronger discipline and better macro-fiscal forecasting so that the aggregate medium-term resource constraints are realistic.

151. **The credibility of the annual budget preparation process as the only route for selecting projects for funding is being seriously undermined by frequent and substantial in-year revisions.** In response to unexpectedly high revenue collections, annual budgets have been amended to include significantly increased capital allocations. This means new projects are entering the budget in the middle of the year, bypassing the more rigorous annual budget process and often without having been sufficiently well planned. Quick disbursement of windfall gains is rarely a good idea, particularly when it involves capital spending, and has probably been affecting the overall quality of the investment program.

**Procurement and Capital Budget Implementation**

152. **A basic framework for open and competitive public procurement has been established in Montenegro, although there remain further improvements to be made, including reducing the administrative burden of the process for contracting authorities and bidders alike.** The 2006 Law on Public Procurement is broadly in line with EU directives, but requires further revision to be fully harmonized; this is underway. The transparency of the process has improved markedly as a result of legislative reform.

153. **Implementation of the new public procurement systems is lagging behind legislative reform.** The main reason for this is a shortage of capabilities to apply the new procurement procedures and greater efforts are needed to train and retain staff. The Public Procurement Agency has overall responsibility for organizing training for contracting authorities, but is itself short of appropriately qualified staff to carry out this responsibility as well as meeting its other obligations. There is also no independent training capacity. The result is that little formal training of procurement officers is taking place. More attractive conditions of service in the private sector also mean that there is a constant drain of staff with saleable qualifications, particularly to bidders in the procurement process.

56
154. Contrary to the spirit of the public procurement law, contracts are largely being awarded purely on the basis of the lowest bid price without taking other factors into account. The law stipulates that the applicable criteria should be the economically best offer and the lowest price, allowing room for selection on the basis of best value. It is frequently the case that winning bidders, chosen purely on the basis of the lowest price, then go on to increase the contract value through subsequent variation orders during implementation, leading to delays and cost over-runs. The suspicion is that the consistent choice of this criterion of selection - in spite of the availability of a more finely tuned approach that could take some account of proven capacities to deliver works on time, to budget and at the right quality - indicates the possible existence of governance concerns and possible collusion.

155. The small size and relatively closed nature of the market for public works in Montenegro presents problems for procurement. The level of competition is limited as a result and there is increased potential for collusion among the relatively small number of potential bidders.

156. Reasonably robust project management arrangements and project accounting and cost control systems are in place in the three specialized investment directorates which are responsible for most public investment. For a small country, this is a practical way of concentrating scarce project management capacities in one place. The existence of good systems does not, however, prevent the continuous upward pressure on costs that seems to result from the distorted bidding and tender evaluation system. Some of the larger ministries, e.g., education, have units for implementing smaller projects that do not fall within the scope of the investment directorates.

157. Also because of this centralized system of project implementation, monitoring is relatively straightforward in Montenegro. The three investment directorates submit quarterly reports to the MOF, which then submits consolidated reports to the Government. Reports cover physical and financial progress, identifying and explaining any delays in project execution and announcing any possible cost overruns or savings. On the basis of monitoring reports, the MOF can redirect unused funds to other capital projects or from slow to faster moving projects.

158. The recently enacted Law on Spatial Planning and Building of Objects has contributed to speeding up implementation by stipulating a public interest motivation for the expropriation of land. Previously, expropriation procedures had posed considerable delays to project implementation, especially for roads.

159. Various procedures are in place to ensure the quality of completed works. The Law on Spatial Planning and Building of Objects sets out the procedures for monitoring construction standards and for project completion, including obtaining a utilization permit. The investment directorates monitor implementation of works contracts directly and units of the Ministry for Spatial Planning and Environment are responsible for regular verifications of construction works during construction. Upon completion, conformity of a project with technical standards and with legislated technical requirements is confirmed by two committees set up under the auspices of the Ministry of Spatial Planning and Environment. Issuing of a utilization permit requires the supervising engineer to certify that the works have been completed according to the specification in the construction permit and project design documentation. A project for preparing a register of all recently completed capital projects has been included in the 2009 Budget and is being implemented. A register of state assets already exists.

**Evaluation and Audit of Completed Projects**

160. There is no systematic ex post evaluation of completed projects in Montenegro. The State Audit Institution has until now been focusing its attention on compliance and financial audits. Performance auditing has been tested in relation to the program budget model being piloted in certain
budget organizations. Until specification of performance indicators becomes a standard part of program and project preparation, performance auditing will have limited meaning though.

F. SERBIA

Institutional Framework

161. Overall responsibility for public investment issues in Serbia, at the level of the central government, is divided between the Ministry of Finance and the Ministry for the National Investment Plan. These two ministries are in charge of selection (or in the case of MOF, negotiations) and financing of the projects, while there are many implementing agencies (ministries, institutions etc). This division of responsibility is a potentially unsatisfactory arrangement that is liable to lead to inefficiencies and overlapping in planning and implementation of public investments. For this reason, most countries have already moved away from a model where there is a separate ministry with responsibility for investment. In the medium term, organizational arrangements for public investment management will therefore probably need to be revisited. Ideally there should be unique system for project identification, evaluation, selection, preparation, implementation and financing.

162. At the political level, a high level Council for National Investment has recently been created. The Council has responsibility for setting strategic directions for investment in public infrastructure and for making decisions about individual major projects that will be implemented by all levels/parts of the government. This is an important innovation that could substantially improve the strategic orientation of public investment, including the preparation of a regularly updated strategy for public investments with the list of major projects, most important dates, costs and plans for financing. The additional value of this Council is that it represents an effort in the direction of better fiscal coordination, at least in the area of public investment.

Strategic Setting

163. Serbia is missing a realistic and up-to-date national strategy for public investments within which realizable sector strategies and sector investment plans can be developed. Recent political divisions have made it difficult to move beyond what is really the only overarching strategy: the Poverty Reduction Strategy Paper (PRSP), adopted in 2003. This strategy has not had much real influence on policies and expenditure plans and suffered from a number of drawbacks, including vague and inaccurate costing, lack of clarity concerning prioritization and unrealistic financing plans. The strategy also does not pay much attention to infrastructure needs. In addition, the PRSP has generally been perceived as responding to external demands and national ownership has consequently been weak. After the PRSP, there were many sectoral strategies produced (and couple of more cross-cutting strategies, including one for Sustainable Development) and most suffered from weaknesses similar to those of the PRSP.

164. At the sector level, a number of different strategies have been developed, including for investment, but these frequently suffer from lack of internal consistency, unreliable cost estimates and unrealistic expenditure plans. Without a strong over-arching strategy development framework, sector strategies are being developed in a vacuum with no realistic resource constraints, rendering policy making and prioritization difficult. Horizontal coordination is also not strong in the Serbian administration and the strategies are often not consistent with each other.

165. The recent decision on national investment priorities by the Council for National Investment is a step forward in setting out a strategic direction for public investment. This kind of strong guidance from the highest political level has been missing until now. The analytical foundations
for investment priorities are not always clear though and, where there is still opportunity, it will be important to verify that all of the choices represent good value for money. The Council has also only established its priorities in a brief policy statement; more detailed implementation plans will also now be required from the technical level.

**Identification Preparation and Appraisal of Capital Investment Projects**

166. Generally satisfactory definitions of capital expenditure and of what constitutes a project are being used in Serbia, although there is room for some refinement. There is no minimum threshold below which expenditures are considered too small to be classified as capital expenditure, leading to the system being cluttered with small equipment purchases. 'Heavy repairs' remain a grey area encompassing both planned periodic maintenance (current expenditure) and rehabilitation (capital expenditure). Regulations require projects to be adequately scoped to encompass all activities and related expenditures required to deliver sustainable benefits to target beneficiaries.

167. There is a lack of strategic focus in the way some projects are being conceived and planned. Funding through the ‘call-for-proposals’ approach of the NIP has tended to lead to a predominance of small, annual and uncoordinated projects to the disadvantage of larger and more strategic 'programmatic' projects. This bias has been alleviated by a recent Government decision to direct a larger share of NIP resources towards co-financing for major national priority infrastructure projects.

168. Serbia has a well structured and sequenced pre-implementation phase of the project cycle, but it is too oriented towards technical and administrative issues to the detriment of value-for-money analysis. The Law on Planning and Construction governs the technical documentation required at different stages of project preparation, together with the formal approvals, verifications and controls. It sets out a construction approval process requiring completion of preliminary feasibility and feasibility studies. The law is less oriented towards ensuring the efficiency and effectiveness of public investment projects and more towards verifying engineering feasibility and compliance with technical standards and spatial planning requirements, although supporting regulations do give more weight to financial and economic feasibility analyses. It remains to be seen what innovations will be introduced in the process by the new draft of the Law on Planning and Construction, which is about to be adopted.

169. Requiring independent ‘revision commissions’ to peer review preliminary feasibility and feasibility studies is a potentially useful feature of the law. The drawback is that the role of the commissions is narrowly defined to technical engineering matters and does not extend to assessing the likely efficiency and effectiveness of a proposed investment. Revision commissions could be far more useful bodies with the power to challenge project promoters over the extent to which they have demonstrated a good use of public resources, as well as compliance with engineering standards.

170. Performance of some of the prescribed pre-implementation activities is often only superficial and project preparation requirements are generally not being fulfilled to an adequate standard. The process set out in the law seems to be viewed more as a series of administrative hurdles than as an aid to decision making. As a result, there seems to be little consistent use of formal project appraisal methods, including economic analysis based on reliable estimates of demand, and an excessive focus on engineering considerations in making decisions. Shortage of the necessary skills is one reason for the weaknesses in project appraisal, but this is partly a result of the system itself; when little weight is given to a project’s economic performance by decision-makers, the incentive to invest in the requisite skills is not strong.

171. The regulatory system and its enforcement need to be significantly strengthened to create a sound basis for controlling the quality of investment project proposals. Greater coordination
between the Ministry of Environment and Spatial Planning, the Ministry of Infrastructure and the Ministry of Finance will be necessary to achieve these improvements. Improvements should involve:

- Greater emphasis in the law on verification of project efficiency and effectiveness.
- More explicit criteria for deciding when a project should proceed from one stage to the next.
- Making the preliminary feasibility study closer to a preliminary screening step, with more emphasis on value-for-money, policy coherence and fundability.
- Extending the remit of the revision commissions to include value-for-money.

172. No detailed methodological guidelines on carrying out feasibility studies and appraisal in the public sector have yet been developed for Serbia. A promising start has been made by the Ministry for the National Investment Plan, which is developing a manual designed to provide methodological guidance right across the project cycle, consistent with EU and international practice. The drawback is that the manual and procedures apply only to the projects funded from the NIP allocation. A more fruitful approach might be to extend this guidance to all public investment, but to include tailored advice for NIP projects. A unified set of guidelines could form the basis for designing and delivering more systematic training. Preparation of unified guidance and related training require coordination between the Ministry for the National Investment Plan, the Ministry of Finance and the Ministry of Environment and Spatial Planning under whose authority the Law on Planning and Construction comes.

**Budgeting for Capital Investment**

173. The Serbian central government has a unitary budget presented along organizational lines so that current and capital expenditures can be scrutinized alongside each other. Some ministries are also presenting their budgets along programmatic lines on a pilot basis. No information is currently presented in the budget on the forward expenditure implications of multi-year projects, although the proposed changes to the Budget System Law will improve this.

174. Budget comprehensiveness and transparency is obscured by the existence of the National Investment Plan. While it is true that funding for the NIP is captured in the budget, it is appropriated as a single lump sum and expenditure decisions within this item are subject to a different planning cycle and procedures from the rest of the budget. This opens up the possibility of duplication and failure to take account of the implications of investment decisions for the rest of expenditure in the budget, i.e., current spending. Additionally, actual expenditure under the NIP is accounted for under a special budget code so that there is no record of the economic nature of expenditure.

175. Externally financed capital projects are represented in the budget even though these are not captured directly through treasury system. The Ministry of Finance has in place special procedures for collecting information on these disbursements. It is not, however, certain that all external funding is captured in the budget or in execution data. The most likely gaps relate to donor-funded technical assistance projects which, not being capital spending, do not concern the current survey.

176. The Budget System Law does not adequately empower the MOF to scrutinize projects for their compliance with pre-implementation procedures. The MOF also receives insufficient information through the budget submissions, which only require that capital spending proposals be accompanied by ‘reasons’ and ‘descriptions’. The Ministry’s position could be somewhat strengthened by linking its powers of scrutiny of financial plans to the principles of ‘efficiency’ and ‘economy’ invoked under ‘Budgetary Objectives’ in the Budget System Law. In practical terms, the Public
Investment Division of the MOF also currently lacks the capacities to carry out any kind of rigorous checks. The end result is that it is not unusual for projects for which the preparatory work is incomplete or not yet started to be included in the budget.

177. ‘Construction approval’, under the Law on Planning and Construction, has some of the features of a gate-keeping process, but it is not formally linked to budget preparation. There may be an opportunity for strengthening the construction approval process and giving the MOF a stronger consultative role in defining criteria and in validating projects. Making construction approval a pre-condition for projects to be included in budget holders’ proposed financial plans, could then be an effective check on procedural regularity and project quality. This would require bolstering coordination between the Ministry of Environment and Spatial Planning, responsible for the Law on Planning and Construction, and the MOF, responsible for the Budget System Law.

178. Project selection in some cases is politicized and decisions on which projects will receive funding are not always made through a structured process forming part of budget preparation nor is there an explicit link to the existing sectoral strategies. Politically driven projects are often inserted into the budget during its preparation; worse, decisions to start projects can be made mid-year, leading to the accumulation of arrears for unbudgeted works or a slowing of implementation of budgeted projects.

179. There is, as yet, no fully functioning MTEF in Serbia and the budget continues to be prepared with a one year perspective. This is in spite of the current Budget System Law requiring a 3-year perspective, which is only being met at the aggregate level through the medium-term fiscal framework prepared for the Budget Memorandum. The absence of this medium-term perspective and of credible, medium-term resource ceilings by organization causes difficulties for strategic prioritization of public investment and for the development of a realistic pipeline of projects, i.e., consistent with available fiscal space and commitments to ongoing projects.

180. Proposed revisions to the Budget System Law would require the Budget Memorandum to be accompanied by an MTEF for the budget, including comprehensive ceilings broken down by budget beneficiary. If adopted and successfully implemented, these changes would create a much improved environment for capital budgeting, enabling improved strategic planning of expenditures and better prioritization within constrained and more predictable medium-term financial allocations. Project preparation could also be properly planned and resourced within a more stable medium-term budget plan. The introduction of a functioning MTEF will make it easier to plan properly for the operational and maintenance expenditure consequences of capital projects upon completion.

181. The proposed revisions also include a requirement for a medium-term plan for public investment to accompany the Budget Memorandum. The medium-term investment plan - presumably setting out the current and future expenditure implications of ongoing and new projects in more detail than would be expected in the MTEF, and possibly covering a longer period - is a sensible idea, but it needs to be firmly anchored to the MTEF in terms of both process and organizational responsibilities. There is a danger of the medium-term plan for public investment becoming like the worst kind of Public Investment Program, i.e., an unconstrained wish-list prepared in parallel to the budget process.

182. There are no systematic checks on implementation readiness employed as part of the budget process. Making construction approval an explicit requirement for inclusion in the budget would go some way to filling this gap.
Since 2002, there has been a complete shift in procurement practices compared to the previous uncompetitive and non-transparent system. New public procurement legislation passed in 2002, 2004 and 2008, means that Serbia has now achieved an acceptable international standard for public procurement regulation embodying the principles of economy and efficiency in the use of public monies. Open, competitive procurement is now the norm, having risen from 28 percent of procurement operations in 2002 to 47 percent in 2006. The 2008 law further improved the system by reducing unnecessary bureaucracy, placing strict limits on the use of negotiated procedures and making the Commission for the Protection of Tenderers' Rights independent. Multi-year construction contracts pose no problem under Serbian procurement law and can be concluded within the framework of an annual budget process.

While a reasonable legal basis for procurement is now in place, much more still needs to be done to improve the overall effectiveness of the system. Until recently, the Public Procurement Office (PPO) had been focusing on its control function to the detriment of system development, training and advice. This has held back the development of a critical mass of professional procurement officers in spending agencies. There are also questions about the level of financial resourcing and human resource capacities of both the PPO and the Commission. Implementation weaknesses give rise to frequently voiced governance concerns regarding procurement of works contracts.

Loose specification of design standards in contract documentation is identified by the MOF as a persistent procurement problem. This results in numerous variation orders during implementation as specifications are revised, leading to loss of control over project costs. This problem might appear to derive from limitations of project preparation, rather than of procurement; however, there have been some suggestions that it may arise from deliberate efforts to circumvent the procurement process.

Limited performance orientation, combined with ad hoc organizational arrangements, suggests that project management is not a strong feature of public investment in Serbia. Ministry of Finance concerns about project budgets creeping up and about the quality of completed works would seem to confirm this conclusion. No formal guidance has been issued on setting up project management arrangements and these are left to individual budget holders.

Individual projects and their associated costs are not currently presented as part of the budget and accompanying documentation, nor is there a comprehensive registry of projects where this information is kept. Project implementation for multi-year projects is not therefore subject to the tight financial control of a system where annual allocations are set in the context of an approved total project cost, expenditures incurred to date and expenditures required to complete after the end of the budget year. The newly proposed medium-term investment plan would establish the basic structure for doing this.

There is no central monitoring of public investment projects nor is there any process for ensuring that spending agencies have good monitoring systems of their own in place. The Law on Planning and Construction places no obligations on investors to set up monitoring arrangements during construction. Monitoring is therefore of variable overall quality. Combined with often ambiguous project management arrangements, this means that active monitoring involving early identification and resolution of problems is not a prominent characteristic of the Serbian system. Where monitoring is performed it is generally only financial monitoring and not physical. A firm basis for more performance-oriented monitoring is also missing because performance indicators are not established as a matter of course during project preparation.
189. If a new web-based project information system being developed by the Ministry for the National Investment Plan is rolled out successfully, it could be a model for a government-wide monitoring system or for more systematic decentralized monitoring. The system is for financial and physical monitoring and cost control. It will be fed by information from PIUs implementing NIP-funded projects. The application form used for securing NIP funding contains information on the scheduling of project activities and will provide a baseline against which monitoring will be performed.

190. There are legal requirements for independent expert supervision of works during construction and for independent technical inspection on completion. Although the legal requirements are clear, anecdotal evidence of poor quality construction suggests that the independence and/or technical competence of contract supervision and inspection are in question and that there is scope for significantly improving the application of the law in this respect.

Evaluation and Audit of Completed Projects

191. Evaluation and audit of completed projects are probably the weakest components of the Serbian public investment management system at all levels of government. Once again, the Ministry for the National Investment Plan is pioneering new approaches in this area that deserve serious consideration for wider application. A procedure for ex post evaluation of projects funded through the 2008 NIP has been initiated and this will assess completed projects against the criteria on the basis of which they were originally accepted for funding. A new application form is being introduced that sets out a clearer framework for performance-oriented monitoring and evaluation, requiring specification of project goal, specific objective and results. Evaluation of the 2009 program (in 2010) is therefore expected to be more systematic and will hopefully benefit from practical guidance contained in the forthcoming project cycle management manual.
APPENDIX 2: KEY FEATURES OF A WELL FUNCTIONING PUBLIC INVESTMENT MANAGEMENT SYSTEM AND RELATED DIAGNOSTIC QUESTIONS

Strategic Setting for Public Investment Planning and Decision Making

Key Features of Strategic Setting:

- Credible, operational and authoritative\(^7\) strategic guidance for public investment planning and decision making.
- A coherent approach to mobilizing funding from different sources, including donors and the private sector\(^8\).

Questions on Strategic Setting:

1. Are strategic plans formulated that are intended to serve as basis for identification, prioritization and selection of capital investment projects? If so, are these plans detailed enough to serve this purpose? Is the sector coverage comprehensive or partial? Are more detailed medium term infrastructure development plans prepared for heavy investment sectors, e.g., roads?
2. Are strategic plans developed within a consistent and realistic medium- to long-term macroeconomic and fiscal framework?
3. Are strategic goals and objectives defined in such a way that they are useful for planning and prioritization purposes, i.e. are they specific, measurable and time-bound or are they general, qualitative and without target deadlines?
4. Are strategic plans reviewed and approved by political leaders?
5. Does the strategic guidance retain its relevance, i.e., are strategic plans reviewed and updated on a reasonably regular basis to reflect implementation experience and changes in macroeconomic and fiscal conditions?
6. Are agreed strategic plans disseminated to those who need them for public investment planning and decision making? Are they publicly available?
7. If there is a Public Investment Program, is its preparation closely linked into the national strategic planning process or is it a parallel process?
8. Is donor assistance coordinated so that it is directed towards national strategic investment priorities?

Identification, Preparation and Appraisal\(^9\) of Capital Investment Projects

Key Features:

\(^7\) I.e. with political ownership.
\(^8\) Matching donors/IFI funding opportunities to government investment priorities; rational criteria and adequate safeguards for involving the private sector.
\(^9\) 'Appraisal' here refers specifically to the process of reaching a decision on whether or not a project is likely to represent a sound use of public monies. A more general meaning extending to preparation of the feasibility studies that inform the decision is also used.
\(^10\) Also referred to here as the 'pre-implementation phase'.
• A robust, yet pragmatic, accounting definition of capital expenditure.11
• A conceptual definition of ‘the project’ that supports strategic planning and budgeting.
• Properly sequenced and disciplined procedures for identification, preliminary screening, preparation and appraisal12 of projects, with formal decisions at key steps, including a decision to proceed to detailed preparation13 after preliminary screening.
• Specification of performance indicators for monitoring and evaluation purposes.
• Independent peer review of appraisal results to check for subjective bias, where ministries and departments (rather than a central unit) are responsible for feasibility studies and appraisal.
• Formal and readily accessible methodological guidance on the technical aspects of project preparation and appraisal, proportionate to the scale and scope of projects.
• Formal guidelines and decision criteria for analyzing alternative procurement arrangements, e.g., traditional contracting as against alternative PPP options, BOT, etc.14
• Upstream training initiatives in project analysis methods.

Questions on Identification, Preparation and Appraisal:

1. Is the definition of capital expenditure being used consistent with international practice and is there a common-sense cut-off point below which technical ‘capital’ expenditures are classified as recurrent?

2. Are capital projects being defined in such a way that they capture all the expenditures necessary to deliver sustainable benefits to target beneficiaries? Are similar, small, site-specific projects being grouped into larger ‘programmatic’ projects for planning and decision-making purposes?

3. How are individual projects concepts usually identified first for further development?
   a. Because they have been listed in the national strategic plan or sector plans
   b. As solutions derived from problem analyses and stakeholder consultations, carried out in response to issues and priorities identified in strategic plans
   c. In response to ad hoc requests from the relevant minister
   d. In response to ad hoc requests from the Government or its leadership
   e. Other - Explain

4. Is there a formal identification step during the pre-implementation stage of the project cycle involving preliminary screening followed by approval to proceed to preparation and appraisal? If yes, what does preliminary screening involve and by which organization is it performed? If there is no preliminary screening of project concepts, what is the basis for deciding to proceed with project preparation?

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11 Periodic maintenance, along with routine maintenance, should normally be classified as recurrent expenditure; expenditure required to make good a previous maintenance deficit, i.e., rehabilitation, should normally be classified as capital. Minor expenditures, even if conforming to a technical definition of capital, should be classified as recurrent for the sake of administrative convenience. The threshold is a country decision, but if set too low will swamp the system and make strategic decision making difficult.
12 And ‘pre-appraisal’ for large, complex or risky projects requiring pre-feasibility studies.
13 Or to a pre-feasibility study in the case of large, complex or risky projects.
14 Procurement options should be examined during project preparation.
5. After identification, is there a regulated set of project preparation activities (e.g. feasibility study, preliminary design, environmental and social impact assessments) that must be completed before a project can be approved for funding? Does this include a requirement for a systematic analysis (qualitative or quantitative) of the life-cycle costs and benefits of the project? Does this include comparison with and ruling out of alternative ways of achieving project objectives?

6. Is economic cost-benefit analysis (CBA) or cost-effectiveness analysis (CEA) required? If so, is it a requirement for: i) all projects; ii) projects above a certain value threshold; iii) projects from certain sectors only; or iv) externally financed projects only?

7. Does project preparation include identification of performance indicators against which implementation progress can later be monitored and project success evaluated?

8. Is risk analysis a requirement of project preparation? If yes, what does it cover: i) costs only; or ii) costs and benefits?

9. What other preparatory work, if any, is required before a project can be approved for funding?

10. Are project preparation requirements generally fulfilled to an adequate standard? If not, why not: i) shortage of professionals with necessary skills (either in government or commercial consultancy organizations); ii) shortage of financial resources; iii) weakness of central authorities to enforce the application of these requirements; or iv) general belief that the results of project preparation activities will have limited bearing on actual decisions on which projects will proceed and which will not. Is there any variation between sectors?

11. Is formal guidance issued on analysis methods for feasibility studies and are these methods tailored to the scale and complexity of projects, the nature of the sector and/or to the capacities of implementing agencies? By which organization is this guidance issued? Is there any proportionality in the sophistication of analysis methods, e.g., application of simpler techniques for lower value projects?

12. Are there well designed and sustainable training programs to build and maintain capacities in the application of the guidance across the main investing ministries?

13. Is there a formal appraisal step in the pre-implementation phase when a decision on the feasibility of a project is taken and its eligibility to be proposed for funding is confirmed? If yes, is appraisal performed by an independent agency? What pieces of preparatory analysis are taken into account in reaching an appraisal decision – technical, financial, economic, environmental, social or risk analysis? Are any quasi-quantitative assessment tools, like multi-criteria analysis used to weigh up the different factors?

14. Are there guidelines on analyzing the case for using PPP approaches? If so, do they include clear criteria for choosing PPP over traditional contracting, including demonstration of significant risk sharing and efficiency savings through involving the private sector?

15. When project preparation and appraisal is performed by the spending ministry that will be responsible for implementing the project, is there any independent peer review of appraisal results, particularly for higher value projects?

16. To what extent are national project preparation procedures being harmonized with EU procedures for pre-accession assistance?
Budgeting for Capital Investment

Key Features:

- Capital spending clearly distinguished within a unitary budget.\(^{15}\)
- A comprehensive coverage of capital expenditure in the budget.
- Explicit recognition of future commitments to ongoing (multi-year) projects in the annual budget or accompanying supplementary information.
- 'Gate-keeping' procedures to stop projects that have not been screened, i.e., passed through designated pre-implementation procedures\(^{16}\), from entering the budget.\(^{17}\)
- A budget preparation process that:
  - Provides the unique route for selecting projects for funding;
  - Is framed within a medium term perspective;
  - Establishes realistic, but hard, expenditure limits for public investment, enabling spending ministries to prioritize their capital expenditures effectively over time, selecting sound, new projects that address their strategic priorities, while continuing to implement ongoing projects efficiently; and
  - Ensures planning of expenditures required to operate and maintain existing fixed assets and additions to assets.
- ‘Ready-to-go’ checks to ensure that plans (including procurement plans) are in place, for efficient and timely implementation before the budget year begins.
- Robust procedures for rationalizing projects that have been stalled because of shortage of funding.

Questions on Budgeting for Capital Investment:

1. Is capital expenditure captured and clearly identifiable within the framework of an integrated budget presentation? If not, explain how capital expenditure is dealt with in the budget.
2. Is the budget comprehensive in its treatment of capital expenditure, notably foreign-financed capital projects? Is there significant capital expenditure by extra-budgetary funds? Are PPP projects and associated public sector liabilities (actual and contingent) represented in the budget or accompanying documentation?
3. Does the budget presentation contain any information on the forward capital expenditure implications of ongoing and new projects - at a minimum, total estimated cost and balance to complete\(^{18}\)?
4. Does the budget process incorporate procedural safeguards to make sure that only projects that have been properly prepared and received a positive appraisal can be considered for

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\(^{15}\) This does not mean a separate capital budget or a two-part 'unitary' budget. It means that there is a clear differentiation between capital expenditure and current expenditure, but the two types of expenditure can still be seen alongside each other for each budgetary organization. More detailed information on capital spending, i.e., by project, can supplement the budget.

\(^{16}\) Identification, preparation – including feasibility study and appraisal.

\(^{17}\) There may need to be a fast-track route for emergency projects, but the definition of an emergency needs to be very tightly controlled to avoid abuse.

\(^{18}\) This might be provided in an annex to the budget or as supplementary information to decision-makers.
budget funding? If such safeguards exist, which organization or organizations are responsible for applying them? How effective are the safeguards, e.g., is it difficult to stop politically motivated projects with shallow justifications from entering the budget at the expense of ongoing projects?

5. Are final funding decisions for projects made through the budget process or are there other routes?19

6. Does Parliament have the right to amend capital budget proposals or is its role confined to rejecting or approving the executive’s budget proposals? If this right exists, is it regularly exercised in relation to the composition of capital budgets?

7. Does selection of projects for inclusion in the budget involve verifying the consistency of projects with strategic plans? Is account taken of spending commitments for ongoing projects before selecting new projects? What other factors are taken into account?

8. Are realistic expenditure limits (‘ceilings’) established early in the budget preparation process and prior to prioritization and selection of projects for funding? Are separate ceilings set for current and capital expenditure? Are ceilings set by sector or by main budget holder? Are ceilings largely respected or are overloaded budget requests the norm?

9. Is there a credible MTEF (or equivalent) process that provides a framework for spending ministries to develop a project pipeline and program its implementation? If there is an MTEF, but it lacks credibility, is this because it is largely a parallel process, insufficiently integrated with budget preparation or are there other reasons?

10. Is there any requirement for projects to be ‘ready-to-go’ before they are finally approved for inclusion in the budget, i.e., formal verification of: detailed design; tender documentation; implementation plans; and surety of any necessary co-funding?

11. Does the MTEF-budget process require spending ministries to make explicit budgetary provision for the future current expenditure requirements (operation and maintenance) of capital projects once completed?

12. Is there a substantial backlog of projects that have been stalled, often for many years? Has there been any recent attempt to rationalize this backlog of projects? Did it result in the closure of a significant number of projects? If not, why didn’t it work: i) lack of political will; ii) no operational criteria for closing projects; iii) shortage of capacity to complete the rationalization; iii) other – explain.

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19 Projects will ultimately have to be funded from the budget, but the funding decision might have been made in another domain, thus undermining the budget process by creating a prior claim on budgetary resources.

20 Separate current and capital ceilings can be helpful for PIM, but are not essential: with aggregate spending ceilings the current/capital trade-off is left to the main budget holders to determine. If the Government has targets for the aggregate level of public investment it needs to set separate capital ceilings.

21 Ceilings need to be set by organization to compel budget holders prioritize their expenditures.

22 ‘Credibility’ may be difficult to assess. Credibility depends to a large extent on whether the ceilings that are decided through an MTEF process become firm constraints for annual budget preparation (and execution) and on whether ceilings for outer years are good predictors of future budget allocations, thus enabling stable strategic planning. Credible capital ceilings need to take account of commitments for completion of ongoing projects. Credible ceilings should in turn foster realistic budget requests. SIGMA assessments of PEM country systems usually have something to say on budgeting and the level of development of an MTEF.

23 ‘Stalled’ does not necessarily mean there is no spending on the project: there may be some minimal spending on safeguarding completed works, but this will not be at a level that is consistent with ongoing implementation.
Procurement and Capital Budget Implementation

Key Features:

- Competitive, efficient and transparent procurement and contracting procedures aimed at delivering economy in the use of public resources.
- Ability to make multi-year contracts within the framework of an annual budget.
- Project management arrangements with clear lines of accountability for delivering agreed project outputs on time and to budget.
- Robust project accounting and cost control systems.
- A responsive monitoring process, involving regular reporting and timely identification and resolution of potential problems.
- Adequate flexibility to respond to material changes in project circumstances, e.g., significant real cost increases or benefit decreases, by re-designing or permanently halting projects.
- Independent verification of works during implementation and before acceptance of completed projects.
- Maintenance of up to date asset registers and recording of asset values.

Questions on Procurement and Capital Budget Implementation:

1. Are capital projects generally implemented by private contractors and, if so, are most contracts awarded on the basis of competitive tenders? Is public sector procurement governed by an adequate legal and regulatory framework? Is it consistent with EU requirements, including openness to international competition? Does it allow for multi-year contracting? Are the required procurement processes generally followed or is there evidence of significant departures? How frequently are restricted tenders procedures or negotiations with a sole supplier used? Is there an independent appeals procedure?

2. Does the budget system and procurement legislation allow for multi-year contracting for implementation of major investment projects running over more than one year?

3. Are there any formal guidelines on project implementation? Are organizational arrangements for project management and oversight laid down? Do these make clear who should be made responsible for delivering project outputs and to whom they are answerable? Do the arrangements vary with project scale? Are project steering committees established for major projects? Is independent external expertise used for managing major projects and supervising contractors?

4. Do accounting systems and budget coding allow separate accounting for individual projects at the central level or is project accounting decentralized? Is cumulative project cost recorded against total estimated cost, as well as annual cost being recorded against agreed annual budget appropriations? Is up-to-date financial information accessible to project managers?

24 The 2008 SIGMA assessment report on public procurement should be a useful source for answering this and the following questions.

25 Eventually national procurement law will have to be fully harmonized with the relevant EU directives. If this is not yet the case, national procurement law may nevertheless be broadly consistent with EU directives.

26 This is usually achieved by making disbursements under contracts conditional on annual appropriations being made available through the budget.
5. Is there an implementation monitoring system supported by regular and reliable reporting on the progress of individual projects from project managers? Is monitoring confined to financial progress or is wider project performance monitored against indicators specified during project preparation, i.e., progress against timetable, against activities or against outputs?

6. Is monitoring largely passive or are there mechanisms in place for identifying problems early and making sure that corrective action is taken, e.g., regularly convened project steering committee able to issue instructions to project managers?

7. Are procedures in place requiring an authoritative review of ongoing projects where cost estimates escalate significantly above the original total estimated cost or where changed circumstances threaten the scale of forecast benefits? If so, can such a review lead to adjustments in the original project design or even closure?

8. Is there a system for independent supervision of works contracts and independent verification of completed works?

9. Is there a formal project completion procedure where completed projects and their values are recording in an asset register?

**Evaluation and Audit of Completed Projects**

*Key Features of Evaluation and Audit:*

- Systematic ex post evaluation of completed projects.
- Feedback mechanisms, ensuring evaluation results feed into new project design and project selection decisions.
- Supreme Audit Institution with the mandate and capacity to undertake performance audits of projects, as well as financial/compliance audits.

*Questions on Evaluation and Audit*

1. Is there a systematic process for evaluating project performance after completion? Is this confined to comparing forecast with realized costs or does it extend to an examination of project efficiency and effectiveness. For those projects where it was originally required, is CBA performed again using realized costs and benefits? Are all projects evaluated, or just a sample? Which organization is responsible for carrying out evaluations?

2. To which organizations are evaluation reports circulated? Is there a requirement for findings from relevant evaluation reports to be taken into account during identification and preparation of new projects? Does the finance ministry take account of evaluation reports when reviewing spending ministries' capital budget proposals?

3. Is there a functioning Supreme Audit Institution. Does it audit individual projects? Are all projects audited or only a sample? If a sample, what is the basis for sampling; i) random sampling; or ii) risk-based sampling? Are performance audits carried out as well as financial/compliance audits?