THE POWER OF PUBLIC INVESTMENT MANAGEMENT
Transforming Resources into Assets for Growth

COUNTRY CASE STUDY

Western Balkans: Public Investment Management and the EU Effect

Simon Groom

2010
This case study is one of a number of country cases in the Public Investment Management Series. The country case studies accompany the volume, “The Power of Public Investment Management: Transforming Resources into Assets for Growth”, World Bank (2014), and apply a common methodology to assess PIM systems globally.
WESTERN BALKANS

The chapter summarizes the findings of diagnostic studies of public investment management (PIM) processes in six Western Balkan countries. Carried out in 2009 by the World Bank, the studies applied a similar approach to the diagnostic framework described in the World Bank working paper by Rajaram et. al. (2010). The chapter is organized around that study’s eight “must-have” features and their related indicators. All six countries are aspiring EU members and the chapter focuses particularly on a potential “EU effect” on improving national PIM systems.

The key finding is that, except for externally financed investments, preliminary screening and rigorous project appraisal techniques are rarely used, even in those cases where these are prescribed. Ex post evaluation of public investment is also largely undeveloped. Across the region systems are gradually being put in place to improve PIM, but implementation is handicapped by a shortage of skilled practitioners. This is not the only explanation, though, and the conclusion of the chapter is that creating the demand for improvements in the efficiency and effectiveness of public investment will be as important as building capacity.

The chapter identifies an “EU effect” but finds its impact rather limited. Harmonization with EU practices in public financial management focuses on public internal financial control and public procurement because these are the important areas for safeguarding EU funds. Therefore these are also the areas of PIM where a positive integration effect can be identified. The weakest areas of PIM identified in the chapter are found to be influenced little by the accession agenda.

This chapter summarizes the findings of a 2009 World Bank review of public investment management (PIM) systems in the Western Balkans during the first half of 2009 (World Bank 2010). The review drew on four sources in the design of a survey questionnaire to structure interviews and analysis. Six individual country studies detailing practices in Albania, Bosnia, Kosovo, Macedonia, Montenegro, and Serbia were prepared to this review. These were written in a common format to facilitate comparison but may also be read as stand-alone pieces in the main report of the *Western Balkans Public Investment Management Study* (Report 53768-ECA, World Bank, April 2010). The review was performed with an eye to improving practices over the medium term, sharing experiences on a regional basis, providing initial recommendations, and identifying areas for more intensive analysis. Drawing from both the review and the country reports and allowing for any data limitations, the analysis here is intended to be as close as possible to the PIM assessment framework developed from the paper by Rajaram et al. (2008). As all six countries aspire to join the EU, this chapter further explores the extent to which there is an identifiable “EU effect” in the development and functioning of PIM systems. Box X.1 describes some of the channels through which such an effect might operate.

The best public investment management systems will fail to produce results if they are undercut or circumvented by ad hoc decisions. Some countries have advanced well in certain areas, and other countries in other areas: from all there are lessons to be learned. 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. An important theme, therefore, is that, having established what good practice is, it is crucial to make sure that it is actually practiced.

**Box X.1 Accession to the European Union**

All six countries included in the Western Balkans study aspire to EU membership and three—Macedonia, Montenegro and Serbia—are now official candidates.

In 1993 the European Council set out the membership criteria for the eastward enlargement of the EU. These “Copenhagen criteria” require that a state has the institutions to preserve democratic governance and human rights, has a functioning market economy, and accepts the obligations and intent of the EU. These criteria were added to in 1995 with a requirement that a candidate must have created the conditions for its integration through the adjustment of its administrative structures. Part of this adjustment involves the transposition of European Community legislation into national legislation, but there is also a requirement that the legislation be implemented effectively through the appropriate administrative and judicial structures.

The body of legislation that candidates (and potential candidates) must transpose is known as the “acquis communautaire” (JRC 2006). It is divided into 31 chapters around which negotiations are organized. As far as PIM is concerned, chapter 1, “Free Movement of Goods”, and chapter 28, “Financial Control”, are the most relevant. Free movement of goods includes fair and non-
discriminatory public procurement and financial control covers public internal financial control (PIFC) and external audit.

For each candidate and potential candidate, the European Commission prepares an annual report on progress towards meeting the criteria and adopting the *acquis*. The Stabilisation and Association Process is the EU integration framework for the Balkans. Potential candidates sign Stabilisation and Association Agreements and European Partnerships. Once countries are accepted as official candidates Association Agreements and Accession Partnerships are signed and negotiations begin.

Trends in public capital spending in the six countries are illustrated in figures x.1 and x.2.

**Figure X.1: Total Public Capital Expenditure as % of GDP, 2003–08**

*Sources:* National authorities and World Bank staff estimates.
Figure X.2  Total Capital Spending as % of Public Spending, 2003–08

Sources: National authorities and World Bank staff estimates.

Most of the countries increased the share of public capital spending in GDP over the period 2003–08, but in three out of the six countries, Albania, Kosovo, and Montenegro, the share increased extremely steeply from 2007 to 2008. The rise in GDP, at least until 2008, also meant that there were significant increases in real expenditures on capital. Bosnia is the only country that did not follow the regional trend, its share at the end of the period being much the same as at the beginning. Kosovo’s share declined marginally from 2004 until 2007, before the very steep increase mentioned. More recently, capital spending has likely become compressed as a result of fiscal adjustments related to the effects of the global financial crisis.

In terms of the share of capital in public spending, a distinction can be made between Albania, Kosovo, and Montenegro, on the one hand, and Bosnia, Macedonia, and Serbia, on the other. In the first group, capital spending represents a much higher share of total public spending than it does in the latter group.

The share of public spending devoted 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. In Bosnia, Macedonia, and Serbia, capital spending was in the vicinity of 10 percent of total public spending in 2007. For Serbia, this represented an increase over the low of 5.6 percent in 2003; the other two countries showed no distinctive trend in previous years. In Macedonia, the share 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.

Only for Albania and Bosnia were good data available on the breakdown of the share of capital by domestic and external funding sources. In Bosnia the proportion of foreign-financed public investment increased from around half to just over three-quarters over the period. In Albania the share of foreign financing fell until 2007, when it reached 16 percent, only to rebound to 45 percent in 2008 when an increase in the availability of external resources—through
borrowing from international capital markets, not concessional lenders—explains the entire increased share of public investment in GDP.

Execution rates for capital expenditure generally seem to have improved across the region, although data were not available for Bosnia and Serbia. All the same, table x.1 shows that there was still significant under-execution of the capital budget in Albania, Kosovo, and Macedonia in 2008. Kosovo saw the most significant improvement, from a low of just over 60 percent in 2004. Macedonia experienced significant over-execution in 2007, indicating the likelihood of problems in expenditure control.

<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>—</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>—</td>
<td>—</td>
<td>76.3</td>
<td>77.0</td>
<td>111.1</td>
<td>92.7</td>
</tr>
<tr>
<td>Montenegro</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>94.2</td>
<td>100.7</td>
<td>100.5</td>
</tr>
</tbody>
</table>

Source: National authorities and World Bank staff estimates.

Strategic Guidance and Preliminary Screening

National Development Strategy and Sector Strategies

The quality of strategic guidance for public investment planning and decision making was found to be one of the weaker links in many PIM systems in the six study countries. Government officials consulted during the surveys frequently expressed their frustration regarding the absence of credible and operational strategic guidance from the political level upon which to base project identification, prioritization, and selection decisions. This does not mean that no strategic guidance has been available; however, credibility depends on buy-in at the political level, on demonstrated affordability, and on continued relevance, all of which are often missing. Well-articulated and tightly defined strategic objectives and logical coherence are also required to make guidance operational, and these elements are also often absent.

Several countries initiated overarching national development strategies to meet external requirements for Poverty Reduction Strategy Papers (PRSPs), but these have largely come to nothing in terms of their practical impact on expenditure decisions. Mostly viewed as donor-driven exercises and completed with significant amounts of technical assistance, these strategies rarely gained the necessary political momentum or ownership. The Bosnia Mid-Term Development Strategy, the Serbia Poverty Reduction Strategy and the Kosovo Development Strategic Plan have all effectively stalled. The exception is Albania, where the National Strategy for Development and Integration 2007–13 (NSDI) has emerged as a unifying strategy with strong national consensus with triple endeavors to address PRSP issues, EU integration, and NATO membership. It is interesting to speculate on the convergence of circumstances that made things different in Albania. A reform-oriented prime minister and minister of finance, together with a political consensus on EU
integration, were vital. Timely and effective technical assistance was also important, particularly in advising on institutional arrangements for an integrated planning system (box X.2), which ensured that the Council of Ministers, the Ministry of Finance, and the Department of Integration were working within a unified planning framework with a unique calendar. The newly created Department for Strategy and Donor Coordination under the Council of Ministers has also made an important contribution to more cohesive planning.

**Box X.2  Albania’s Integrated Planning System**

Recognizing that Albania’s policy and financial planning systems were fragmented and disjointed, the Government of Albania in November 2005 committed to implementing 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: (1) the National Strategy for Development and Integration, providing a single comprehensive strategy covering all sectors and (2) the MTEF (Medium-Term Expenditure Framework)/budget process requiring line ministries to project their medium-term expenditure plans to deliver their policy objectives and goals within each ministry’s expenditure ceilings. The IPS also emphasizes a requirement for stronger strategic direction from the Council of Ministers, which will 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: (1) an inter-ministerial Strategic Planning Committee chaired by the prime minister, (2) a Government Modernization Committee chaired by the deputy prime minister, and (3) the Department of Strategy and Donor Coordination (DSDC) located within the CoM Secretariat and responsible for coordinating IPS across government. The IPS is being implemented in phases. 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.


Albania has indeed made significant progress since the World Bank’s 2006 “Public Expenditure and Institutional Review,” which described the strategic planning context as beset by the following problems:

- Overlapping and fragmented policy frameworks that failed to give a clear and manageable vision for public policy design and implementation;
- Separate planning and management arrangements for different strategic initiatives;
- Uncoordinated institutional responsibilities for strategic planning; and
Strategies and plans that had been developed without taking adequate account of fiscal constraints and new policy priorities that were not being sufficiently reflected in budget decisions.

This description of the challenges Albania faced in 2006 was typical of many of the countries in the region at the time of the study. As well as the tentative national frameworks already mentioned, most countries had a patchwork of sector strategies, some with investment components and others without. Often completed at different times, usually with no common guidance and no shared national resource framework, these strategies tended to have a limited impact on investment decision-making.

In contrast, Albania's NSDI was founded on a national vision and a comprehensive set of sector and crosscutting strategies. In consultation with the Department of Strategy and Donor Coordination at the Council of Ministers (CoM), ministries led the development of their own sector strategies, which included broad costing of policies under alternative scenarios for resource availability. The implementation costs of the NSDI were estimated at the sector level (underpinned by more detailed costing of individual measures and projects in some but not all cases) and framed within a medium- to long-term macroeconomic and fiscal perspective to demonstrate the overall realism and sustainability of the strategy. Finalization of the national strategy involved assessment of the financial implications of all sector strategies with the Strategic Planning Committee (a subgroup of the CoM) resolving conflicts and making the necessary expenditure trade-offs to ensure the affordability of the strategies in aggregate before approval by the CoM.

The NSDI document includes a specific section on economic infrastructure covering transport, energy, wastewater and sanitation, and environment, which sets out the challenges, vision, and strategic policies and priorities by sector. Major investment priorities for the planning period, for example, upgrading of specific road segments in priority transport corridors and construction of specific hydroelectric power plants, are listed in the NSDI, and more general priority areas are given for smaller investments, for example, investment in local and rural road networks in cooperation with local government. However, the quality of the individual sector plans that form the basis for the NSDI is variable and frequently a function of the level of external technical assistance that had been made available.

It would be entirely wrong to imply that there was no further room for improvement in Albania: First, preparation was not necessarily executed as smoothly as the somewhat idealized description above might suggest, and the resulting strategic guidance still has some important weaknesses. Second, short-term political imperatives are still guiding investment choices as much as the strategy. It should also be recognized that Albania's model of an overarching national strategy has not been universally adopted. Ireland’s National Development Plan is an often quoted example of such a national strategy, but it is probably the exception rather than the rule among OECD countries. In these countries strategic planning at the sector or ministry level is more common, although strategies focused specifically on national infrastructure development—rather than wider social and economic development—have become more common. All the same, EU integration ambitions are likely to lead countries in the region down the same path as Albania, so its example is relevant. Macedonia—which as an EU candidate country must prepare a National...
Development Plan to unlock pre-accession assistance—has already made a good first attempt. Macedonia’s plan, developed in 2007, provides a coherent three-year framework setting out investments that are consistent with overall national development goals and to be jointly financed by foreign and domestic public resources. However, as elsewhere, political buy-in has been the issue, and a subsequent annual update is yet to be endorsed by the Government. Although not yet a candidate, Bosnia is preparing the Bosnia Development Plan as a precursor to the requirements of candidature, although national ownership is even more of an issue in this politically fragmented state.

In many respects, therefore, EU integration can be seen as a progressive force in the development of strategic guidance for public investment. As well as promoting national planning, initiatives to develop integrated regional networks—for example, the EU trans-European transport network (TEN-T), which identified key transport corridors for development or upgrading—have been instrumental in guiding investment decisions throughout the region, often overriding weaknesses in national strategic planning, but also running the risk that regional integration priorities could take precedence over more pressing national priorities (for example, international roads as opposed to local roads). All the same, there are valid concerns about the extent of national ownership of plans and strategies that are prepared to satisfy external pressures.

The discussion of strategic guidance should probably not leave out public investment programs (PIPs), although their role can be seen as bridging strategic guidance and budgeting. Variously understood as strategic planning instruments in their own right, as tools for implementing the investment component of national or sector strategies/plans, as systematic project appraisal systems, or as vehicles for coordinating donor project assistance, PIPs have sometimes been cast as public financial management (PFM) “villains” because of the fragmentation they can introduce to budgetary processes. Experience in the region has so far done little to dispel this impression (box X.3).

**Box X.3: Public Investment Programs—a Dead End?**

A number of countries in the region have PIPs, or have had them, but the motivation for forming them is not always evident. Given the usual involvement of donors, at least at the beginning, donor coordination would often seem to be the dominant motivation. Whatever the case, the level of strategic guidance they offer seems to be limited, and the region’s PIPs more often than not have tended to be unconstrained wish lists of poorly screened projects searching for funding. Macedonia, for example, has had a PIP since 1998, and the Government has only recently taken steps to integrate it into mainstream budgetary processes—and then with only partial success (ambitions in outer years are still unrealistic). Bosnia has had PIPs for nearly as long, with the same dissociation from budgeting and, hence, equally limited impact, although it recently has been trying to reinvigorate the process (with donor assistance—again!). Albania sustained a largely ineffective PIP for many years, with responsibility passing between several ministries before it ended up in the finance ministry where it was finally laid to rest in favor of a theoretically more integrated
approach to strategic planning, budgeting, and donor coordination (box x.2). In practice, though, recurrent and investment budgeting are still not fully integrated, in spite of the demise of the PIP.

Kosovo and Montenegro are putting substantial efforts into developing their PIPs, the latter benefiting from substantial EU assistance in this area. The design of these PIPs appears to have benefited to an extent from the lessons learned elsewhere, and designers have put a strong emphasis on systems for “quality control” of projects. Issues remain concerning integration with budgeting and compatibility with potentially competing MTEF (Medium-Term Expenditure Framework) initiatives, however. In Kosovo the lack of disciplined application of PIP procedures is also a problem, as they are often bypassed. Included in the 2009 revision of Serbia’s Budget Systems Law is a requirement for a “medium-term public investment plan” expressing public investment priorities. In many respects this seems like a PIP, but with the advantage that explicit linkages have been made with the budget process. It remains to be seen whether these new PIPs bear fruit, but, based on regional experience to date, the omens for success are not too promising.

Perhaps in recognition of some of the weaknesses in strategic guidance for public investment, several of the countries have established high-level political committees to give more direction to public investment, for example:

- Kosovo’s National Investment Committee;
- Macedonia’s Strategic Investment Committee, chaired by the prime minister and including key ministers and directors of important institutions; and
- Serbia’s Council for National Investment comprising the President, the prime minister and the Ministers of Economy, Finance, and Infrastructure.

These are positive signs; however, unlike Albania’s Strategic Planning Committee, which has a clearly demarcated role in the country’s Integrated Planning System (box X.2), and in the sub-dimension of capital budgeting, the bodies in Macedonia and Serbia do not form part of a broader reform of the institutional framework for planning and budgeting, and, consequently, their influence could end up being short-lived. In the absence of a more formal supporting technical and analytical infrastructure to support the committees’ work, “politics” and “policies” also risk becoming confused. Kosovo’s National Investment Committee (NIC), on the other hand, is an integral part of the PIP procedures.

First Level Screening to Ensure Strategic Alignment

Among the countries studied only Albania has a first level screening process to ensure the strategic alignment of new project concepts with the relevant strategic guidance. The project proposer for each new concept must prepare a Project Idea Presentation Form (PIPF) and present it to the management team responsible for the appropriate expenditure program. The head of the management team signs off on the PIPF, then submits it to the relevant ministry’s Group for Strategy, Budget, and Integration, which is chaired by the minister and includes senior ministry
officials, for approval for preparation and a subsequent appraisal decision. As well as other information about the project, the PIPF requires a statement of the strategic policy goals and objectives that it will help achieve by alleviating an identified constraint. This is an internal process, and the PIPF is not validated by the finance ministry. Usually it should apply to projects likely to be implemented in the outer years of the medium-term budget planning period, as it is a precursor to more detailed project appraisal, which should be planned and budgeted.

In principle therefore, Albania is a good practice example from the region; in practice though, the PIPF is not yet being used systematically and, where it is used, it is sometimes seen as a bureaucratic exercise rather than as an aid to better informed decision-making. Kosovo’s PIP system is also intended to function as some form of pre-screening, although this is not yet working effectively.

Formal Project Appraisal

Roles in the Planning Process

The former-Yugoslav states generally have inherited laws governing construction and spatial planning that heavily regulate the technical and engineering aspects of project preparation, setting out the sequence of design steps and related approvals necessary before a project can be implemented. To a certain degree, therefore, roles in the planning process are well defined, but the planning process itself is often too narrowly circumscribed and does not generally constitute a structured appraisal procedure for addressing value-for-money considerations.

The relevant laws often come under construction or environment ministries, with a limited say for the finance ministry and its interest in the efficiency and effectiveness of projects. In Serbia, for example, until its 2009 update, the focus of the Law on Planning and Construction was on the technical documentation required at different stages of project preparation, together with the formal approvals, verifications, and controls required along the way, as well as responsibilities for delivering them. Nevertheless, the law does set out a systematic process, including preparation of prefeasibility and feasibility studies, that bears comparison with good practice in terms of the discipline and sequencing of the procedures, even if there are divergences in terms of the intended purpose and detailed content of each stage. This is typical of the laws elsewhere in the region.

The need to better delineate the form and scope of the project planning process has been on the reform agenda for countries in the region for a number of years. Examples of recent initiatives include the following:

- Serbia’s updated 2009 law made “economic justification” a feature of feasibility studies and thus refocused the procedures, on paper at least, toward value-for-money considerations.
- Serbia’s project cycle management (PCM) procedures for projects financed through the National Investment Plan (funded from privatization proceeds);
- Albania’s PIM procedures as part of the manual for medium-term budget programming;
Public Investment Management and the EU Effect

- Federation of Bosnia and Herzegovina’s rulebook for project identification, preparation, and prioritization;
- Republic of Srpska’s procedures for projects to be financed through the Government’s Economic and Social Development Program (funded from off-budget privatization proceeds);
- Montenegro’s draft decree on project preparation requirements and responsibilities; and
- Kosovo’s design of a two-track procedure for screening projects for inclusion in the PIP.

Some of these reforms suffer from being applicable to only a subset of public investment (for example, PCM procedures in Serbia), which is sometimes off-budget (for example, Republic of Srpska). Others suffer from the absence of an explicit link to a formalized decision-making process for individual projects (for example, the Federation Rulebook). And in general, most of the new procedural arrangements are undermined to varying degrees by patchy or ill-disciplined implementation.

Albania’s PIM procedures probably go furthest in setting out a cohesive process with well-defined roles and responsibilities. The procedures apply to all projects, no matter what the funding source. Figure X.3 shows the decision-making process within budget institutions (first-order organizations entitled to budget funding, mostly line ministries); figure x.4 shows the external review, approval, and financing (budgeting) process. Only the biggest projects (see next section on proportionality) go to the Senior Budget Management Group—the senior decision-making group in the finance ministry that decides on the content of strategic planning and budgetary material going to the Council of Ministers—and the Strategic Planning Committee (a subcommittee of the Council of Ministers). The procedures also set out the analytical work required as a basis for the stepped decisions set out in the figures.

The procedures shown in figures x.3 and x.4 link the project cycle with the budget cycle and involve both project screening (that is, quality control) and selection (that is, the funding decision) steps. The procedures allow for the fact that project preparation and appraisal need not be synchronized with the budget cycle and larger projects can be appraised independently of the budget cycle. Good quality projects are then supposed to be collected in a database maintained by the Directorate for Public Investment Management in the MoF, pending a funding decision at budget time, meaning that there should be no automaticity to funding. In practice, though, the project cycle is still largely subordinated to the budget cycle for domestically funded projects, that is, project preparation is rushed through in the short annual budget review timetable, and the database is not fully functional.
Figure X.3  Albania: Decision Process at Budget Institutions


Note: GSBI = Group for Strategy, Budget, and Integration; MTBP = Medium-Term Budget Program; MoF = Ministry of Finance

Figure X.3 describes the internal appraisal process for spending ministries. Project ideas are generated and analyzed by program management teams—the team responsible for planning recurrent and capital expenditures to achieve program policy objectives within program expenditure ceilings. The ideas are presented on the Project Idea Presentation Form and must go through the approval process indicated. Approved ideas can then be developed into projects for internal appraisal, passing through the same approval stages again before being eligible for review and approval outside the ministry, according to the process set out in figure X.4. Projects must have been prepared and appraised internally before being presented to the Department of Public Investment Management to be steered through the approval process. Various levels of analysis are required for appraisal according to the scale of the project (see “proportionality” in the next section).
Public Investment Management and the EU Effect

Figure x.4  Albania: Review, Approval, and Financing Process


Note: MTBP = Medium-Term Budget Program; MoF = Ministry of Finance

Although Albania has a well-structured decision-making process based on value for money and strategic priorities, it probably lacks some of the engineering discipline in preparation and implementation that characterizes the former-Yugoslav countries (where there is perhaps too much focus on this aspect). More effort will also be required before the process can be said to be fully functioning. The same can probably be said of Kosovo.

Formal Technical Guidance

The availability of formal technical guidance on project appraisal methodologies is extremely limited in the region. Albania’s PIM procedures give an overview of cost-benefit analysis and cost-effectiveness analysis (and the resulting indicators), but this summary is insufficient to enable the non-expert to begin to apply these methodologies and it leaves too much room for individual interpretation; for example, no discount rate is specified. In Montenegro, the Handbook for the Economic Analysis of Public Investment Projects (World Bank 1996) and the Manual on Project Cycle Management (EC 2001) were prepared in 2002 with external assistance, but the
guidance was never officially adopted or widely circulated because the responsibility for doing so was not clear. Thus there is enormous room for improvement in the region.

A potentially positive “EU-effect” that has not taken hold is the ready availability of guidance prepared by the European Commission (EC 2008), which might have been used where national guidance was missing. This would seem to make sense, given the integration aspirations of the countries in the region and the linguistic similarities, which means that countries could share the burden of translation. Some EU-specific elements to the guidance, for example, calculation of co-financing rates, would need to be identified as unnecessary for domestically funded projects, and supplementary advice would be needed on national parameter values, such as the discount rate for use in present value calculations. Otherwise, the guidance could be adopted much as it stands and national guidance could then be commissioned later.

Adding to the difficulty in preparing guidance on project appraisal are the continued misunderstandings across the region concerning the differences between economic, financial, and fiscal impact analyses. Often, “economic” analysis is equated with financial analysis and economic benefits with a narrow focus on financial flows and the budget. This is still an important hurdle in many countries.

### Sound Project Appraisal and Proportionality

Across the region the quality of project preparation and appraisal is generally poor, even in countries like Albania and Kosovo with more systematic pre-implementation procedures. Projects are often 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 do exist, they often are followed only superficially, treated more as a bureaucratic exercise than an aid to decision making.

The focus of pre-implementation studies is frequently on engineering feasibility and capital costs, at the expense of demand forecasting, quantification of life-cycle benefits and costs, and estimation of net economic benefits. Very limited use is made of more sophisticated project appraisal techniques, such as cost-benefit analyses (CBA), even when this is a requirement, and project alternatives (including doing nothing) are rarely examined.

Externally financed projects generally are an exception to these negative findings; therefore, where public investment is more reliant on donor financing, for example in Bosnia, the picture is somewhat more positive.

The situation is not uniformly poor however. There is evidence that national consultants can deliver perfectly good feasibility studies. This evidence comes from studies prepared for internationally financed projects in Serbia and the study of Corridor V road upgrading in Bosnia. Also some of the major cities, Belgrade, Sarajevo and Pristina for example, employ sound project appraisal techniques more systematically than national governments. Of course, it still requires capacities within government to prepare terms of reference, select qualified contractors, and review and interpret their work. These skills often exist in sector ministries that have had exposure
to donor methods. There are few signs of a sustainable skill base having emerged within finance ministries.

In terms of sectors, project appraisal tends to be more soundly based in areas of infrastructure where donors have been more active, for example, in road transport projects where skills in using the internationally recognized appraisal tool, HDM 4 (the Highway Development and Management model), have often been developed. However, the extent to which donor practices have “rubbed off” on project planners often tends to be more limited than might be hoped, partly because of the existence of project management units (PMUs) outside the administration.

Box x.4 Croatia’s Motorways—Good Value for the Money?

Croatia is learning the hard way that making good choices in the area of public investment has both a political and a technical dimension. Politically-driven “strategic” investment without the underpinnings of a good capital budgeting process can be very costly, both in terms of the alternative investment opportunities foregone and in terms of the debt repayments that ensue—now over 2 percent of GDP for motorway investment alone.

In many ways Croatia is a success story, having recovered from conflict and acceded as an EU member. Over recent years, expenditure on public investment has been significant. A major share of this spending has been on extending the national motorway network so that it is now among the best in Europe. Much of this investment was carried out by off-budget public companies borrowing with state guarantees. Few value-for-money studies were performed beforehand and the economic worth of much of the spending is now doubtful. Rather late, Croatia has begun to put in place a more effective capital budgeting system. Some of the important weaknesses in project planning and screening have been the following:

- In an environment of decentralized expenditure decision-making, the MOF lacked the capacity to challenge poor investment decisions. Efforts are now under way to strengthen the Department of Budget Analyses and Capital Projects Evaluation.
- There is still no formal framework regulating the project cycle—preparation, appraisal, and monitoring and evaluation, although a draft has been under review for some time.
- With no overarching national infrastructure strategy, investment decision-making has been uncoordinated, leading to duplication, under-exploitation of economies of scale, and fragmented projects (for example, a hospital with no access road—a real example!).
- Mandatory feasibility studies focus on financial, engineering, and environmental aspects of a project, and value for money and risks are largely ignored.
- The feasibility study documentation is not uniquely prescribed, and approaches differ across government.

In many countries, investment in public infrastructure is carried out off-budget through public corporations. Ignoring the sometimes substantial contingent liabilities imposed on the
budget (through loan guarantees, for example) or the subsidies (explicit or implicit) from which the corporations might be benefiting, appraisals by central governments rarely extend to these investment decisions. This practice is misguided, since public monies are involved or potentially involved, which can lead to significant problems. In Croatia, for example, loan guarantees to cash-strapped motorway companies have placed a substantial burden on public finances (see box x.4).

While the World Bank study of the Western Balkans on which this chapter is based (World Bank 2010) did not extend to state-owned enterprises (SOEs) providing public infrastructure services, the project team recognized that this was an important area for further study, since significant investments in motorways, railways, electricity generation, and water supply and sanitation are being carried out by SOEs benefiting from explicit or implicit loan guarantees or direct subsidies.

Several countries have introduced some degree of proportionality into project appraisal. As shown in table X.2, Albania has three categories of projects, each with appraisals of different levels of sophistication.

**Table 2: Proportionality of Appraisal Requirements in Albania**

<table>
<thead>
<tr>
<th>Type of Appraisal/Sector</th>
<th>Infrastructure Sectors</th>
<th>Other Sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Category I—Basic appraisal</strong>&lt;br&gt;Basic information on project rationale, including purpose and reasons for preferring the chosen alternative; benefits are estimated in qualitative terms unless there is an identifiable revenue stream.</td>
<td>Up to lek 100 million (approx. US$930,000)</td>
<td>Up to lek 50 million (approx. US$465,000)</td>
</tr>
<tr>
<td><strong>Category II—Medium level appraisal</strong>&lt;br&gt;As for basic appraisal, but extended to financial and economic appraisal of alternatives and including a “simple” spreadsheet-based cost-benefit analysis using basic demand/benefit forecasting</td>
<td>Above lek 100 million (approx. US$930,000)</td>
<td>Above lek 50 million (approx. US$465,000)</td>
</tr>
<tr>
<td><strong>Category III—Full appraisal</strong>&lt;br&gt;As for Category II, but extended to incorporate full cost-benefit analysis—including more sophisticated demand/benefit forecasting and analysis of major investment alternatives—leading to preparation of a full feasibility study that also encompasses environmental, social, and regulatory impact assessments, as required.</td>
<td>Requirements to be specified on a case by case basis, determined by the nature of the investment and in all cases substantially exceeding the requirements for Category II</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Manual for Medium Term Budget Program Preparation, Albania Ministry of Finance.

In Kosovo's two-track appraisal process, projects with a value in excess of €400,000 (US$522,000) are required to undergo a more rigorous pre-implementation assessment, including cost-benefit analysis. These larger projects must then be referred to the National Investment Committee for review and approval.
Montenegro is proposing to introduce a bolder proportionality, as follows:

- Up to €4.0 million (US$5.2 million): feasibility study not required (unless otherwise defined by the Law on Construction of Objects).
- Above €4.0 million: feasibility study accompanied by CBA required.

It may be argued that Montenegro’s proposed thresholds are set too high, possibly allowing too many relatively large projects to slip through the net without rigorous scrutiny. However, the study concluded that the thresholds represent a pragmatic response to the financial and human constraints facing the country and to the materiality of the decision. From this perspective, it might be more appropriate to ask whether the thresholds in Albania and Kosovo have been set too low, making unrealistic demands on scarce analytical skills. And, indeed, the reality is that neither in Albania nor in Kosovo were the requirements being fulfilled.

A particular feature of both Albania and Kosovo that does not appear to be replicated elsewhere is that the scope of projects is often set too narrowly, thus populating PIM systems with many smaller projects and very few large projects. For example, integral parts of a single, larger infrastructure investment are sometimes being defined as separate projects, or multi-year projects are being split into annual tranches, with each defined as a separate project. 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 and a legal framework for contracting multi-year projects.

This fragmentation is due in part to a failure to delink the project cycle and the budget cycle so that there is only time to prepare requests for small-scale projects or components of larger projects. Another part of the problem is failure to think in terms of more strategic, “programmatic” projects. In Albania the treasury system does not seem to be able to cope with a broader definition of “project,” that is, projects are being equated with contracts. This should be resolvable, but for resistance in the Treasury Directorate. Improvements in defining the scope of projects, leading to an increase in average project size, could go hand in hand with some upward revisions in the analysis thresholds.

Effective Coordination and Scrutiny of Donor-Funded Projects

Albania’s Integrated Planning System (IPS) is described in box x.2 and discussed more fully under the section Project Selection and Budgeting. This system places donor coordination at the heart of planning and budgeting. The Department of Strategy and Donor Coordination, within the Secretariat for the Council of Ministers, is responsible for coordinating the IPS across government. The PIM procedures (figures x.3 and x.4) provide that sound investment project proposals that cannot be funded within realistic estimates of medium-term resource availability be retained within an investment database and channeled to donors to consider for financing. Such projects are reviewed by the Senior Budget Management Group (SBMG) before being proposed for donor financing. Under the IPS, the intention is to produce an annual External Assistance Strategy, identifying priority areas where external assistance is needed. This did not yet appear to have
happened at the time of the study, though. These reforms come after many years of Albania running a parallel and largely ineffective PIP as the main tool for donor coordination.

Other countries have been making efforts at better donor coordination, but they have not advanced as far as Albania. In Serbia, for example, the Sector for Programming and Management of EU Funds and Development Assistance in the MOF has had some success in improving the coordination of external assistance by developing a framework for assessing financing needs (GROS 2008) and then communicating these needs to the donor community. Bosnia, which has benefited from significant official assistance for many years, has been trying to improve donor coordination by strengthening PIPs at various levels in its complex governmental structure. However, Bosnia has significant intergovernmental coordination difficulties to overcome, as well as problems bringing the PIPs back into mainstream budgeting and planning.

Kosovo, a likely recipient of increasing flows of official assistance, is also making efforts to bolster its PIP, but, like Bosnia, it faces the task of bringing the PIP process into line with other budgeting and planning processes. As an EU candidate country, Macedonia is increasingly reliant on the European institutions for pre-accession assistance and is developing the National Development Plan (NDP) as the main coordination instrument. Again, though, mainstreaming this effort is proving problematic. For many years Macedonia too had a largely ineffective PIP process running parallel to the budget, but is at last now attempting to integrate it more closely, although with mixed result so far.

Capacity in Central Agencies and Line Ministries

Public servants in line ministries do not necessarily have to be experts in the use of CBA—they can employ consultants to do this work—but they do need to understand when to employ these tools, how to specify terms of reference, and how to interpret and use the results.

A shortage of staff with the necessary skills is obviously an important part of the explanation for the dearth of sound project appraisal across the region (except in the case of externally financed projects). Both line ministries and public investment units in finance ministries lack sufficient, appropriately trained staff who understand the application and uses of more rigorous appraisal tools like CBA. But as already indicated, some of these skills do already exist in the countries (or can be obtained internationally by national consultancy firms) and have been employed to prepare acceptable feasibility studies of major infrastructure projects. Therefore demand-side considerations, as well as those on the supply-side, may be an important constraint. A value-for-money culture is a long way from taking root among senior government officials and decision makers in many of the countries of the region, leading to weak incentives to develop and retain the necessary skills for commissioning and managing rigorous project appraisals.

A deeper understanding of the constraints facing the adoption of more advanced project appraisal methods seems to be required in the region. Therefore a three-pronged initiative may be the way to make real progress. The first two steps would involve promoting the use of more objective tools to senior management and decision makers in order to create an environment in which project appraisal is systematically demanded, at the same time as initiating carefully targeted
capacity building. The central public investment units in the individual countries are best placed to lead such an initiative—although in some countries, particularly smaller ones, an infrastructure intensive line ministry might take the lead—but they are generally facing their own capacity constraints. A desirable medium-term objective for all the study countries, therefore, could be to build the capacities of their central public investment units to become centers of excellence for project appraisal and ex post assessment methods (including eventually evaluation) within the administration. They could then disseminate good practice to spending ministries by issuing guidelines, offering advice on specific cases, and organizing training. The third prong could involve a drive to greater transparency surrounding the appraisals and ex post assessments (and, later, evaluations) of some individual, high profile projects. This could involve legislatures, supreme audit institutions, civil society, and the media.

One of the smaller countries, Montenegro, has decided to concentrate on project preparation, appraisal and implementation capacities in three “infrastructure directorates”: the Directorate for Public Works, the Directorate for Roads, and the Directorate for Railways. This seems to work well and might be a desirable option for smaller countries where it makes sense to pool scarce capacities in a small number of locations. However, depending on what works are covered, organizations with general responsibilities for public works may not be compatible with sectoral approaches to strategic planning and budgeting. And in larger countries the advantages of pooling might be outweighed by the disadvantages of separating works from wider sector responsibilities, in health or education, for example.

Pragmatic proportionality in the application of the more sophisticated analytical tools, combined with better project scoping in some countries, are also going to be important for making scarce capacity go further, as already intimated.

Independent Review of Appraisal

Shortages of necessary skills and constrained human resources prevent most finance ministries from actively reviewing project feasibility studies and appraisal findings in most countries. It would also be extremely rare for a finance ministry to review project appraisals carried out by donors—donor procedures are universally seen as the donors’ business and quite distinct from what government does. Often finance ministries lack a formal mandate to review and question appraisals for projects proposed for funding. This can be important in countries where the finance ministry sometimes lacks the political weight of a big sector spending ministry like transport. The Albanian system described in figures X.3 and X.4 gives the Directorate for Public Investment Management an explicit role in reviewing and approving appraisals, but at this stage in the implementation of the relatively new procedures, the focus is still on compliance, rather than on the quality of project proposals, that is, whether the necessary preparatory studies have been performed rather than what they say about the quality of the proposal.

Although few systems for independent peer review of appraisal results exist in the region, Serbia’s “revision commissions” does offer a promising model. The ad hoc commissions, made up of independent external experts, review preliminary feasibility and feasibility studies. The recommendations of the commission, which must be applied, are submitted in a report to the
Project promoter. Their effectiveness depends on the strengths of their membership and the degree of political momentum already behind projects. The drawback is that the role of the commissions is somewhat narrowly defined and limited to technical engineering matters; thus, a wider remit extending to the efficiency and effectiveness of a proposed investment would be more useful. Recent revisions to the Law on Construction and Planning to include examination of economic justification as part of a feasibility study may be sufficient to extend the commissions’ remit. Macedonia’s Law on Construction also includes independent review of project designs, but like Serbia, this covers only engineering aspects.

Project Selection and Budgeting

In general, budget preparation processes in the region have become much better organized and more disciplined over the last decade. New budget system laws have been passed setting out a fixed budget calendar which allows adequate time for budget preparation and scrutiny. It is now rare for the legislature to be late in passing the budget. Frequent recourse to supplementary budgets (discussed further in the next section) continues to undermine these positive developments.

Lack of comprehensiveness in budget coverage of capital expenditure is a problem in some countries in the region. The difficulties associated with bringing externally funded public investment on-budget is the biggest issue in this respect. This clearly affects an aid-dependent country like Bosnia more severely. Another important comprehensiveness issue relates to investment funds constituted from privatization proceeds, that is that they can either be entirely off-budget, as is the case of the Republic of Srpska in Bosnia, or not presented in sufficient detail if on-budget, for example, a single line item for all expenditures, as in Serbia. In many cases, donors or international financing institutions still find it impossible to use national budgetary systems for their projects because of continuing weaknesses in those systems. Nonetheless, ways can usually be found, as a minimum, to reflect these expenditures in budgets and in financial reporting and accounting, even if this requires some parallel reporting procedures. Serbia has found a way of doing this and some proposals have been put forward for Bosnia.

Most countries are already attempting to implement medium-term expenditure frameworks14 (MTEFs), but progress has not been uniform and credibility is often lacking, especially with respect to expenditure ceilings. Moving away from a single-year focus is always slow, and establishing the authority and reliability of the new processes always 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), as well as on whether ceilings for outer years are good predictors of future budget allocations, thus enabling stable strategic planning. Most of the countries are still some way away from this yet, but Albania and Macedonia seem to be leading the way.

One of the major problems for some countries is lack of alignment between MTEFs and budgeting, so that they are more or less parallel processes resulting in MTEF ceilings having limited impact on prioritization. This was the case until recently in Serbia, although recent changes to the Budget Systems Law have now harmonized the calendars and given firmer legal status to the MTEF.
Kosovo and Montenegro are also experiencing similar difficulties, in spite of already having a firm legal basis to their MTEF processes. In those countries with public investment programs (PIPs), like Bosnia, lack of alignment between this instrument, the MTEF, and the annual budget can also be problematic.

Albania has tackled the issue of alignment through the Integrated Planning System (see box x.2), which ties medium-term strategic and expenditure planning to annual budgeting (and strategic planning) in a single seamless process and ensures that the ceilings that emerge are realistic and reasonably firm. The country’s progress in this area has been achieved because of high-level political momentum in combination with well-timed technical assistance, but substantial work remains to be done to establish the credibility of ceilings. Macedonia too seems to have been relatively successful in establishing a functioning medium-term perspective to budgeting: medium-term and annual budget planning have merged into one process, so that the first year of the medium-term expenditure framework and the budget coincide, and ceilings are realistic and generally respected. Macedonia, however, does not make a distinction between recurrent and capital ceilings, leaving it to line ministries to establish the balance. While Macedonia’s MTEF process is beginning to be taken seriously, there is more work to do before it becomes firmly embedded institutionally. Macedonia has been less successful in linking strategic planning to budgeting: although a system with some similarities to Albania’s has been put in place, its functioning is compromised because of poor coordination between key players, that is, the Government Secretariat and the Ministry of Finance.

Most finance ministries in the region are not performing a credible gatekeeping role, that is, checking 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 gatekeeping. 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 and a clear mandate for the Department of Public Investment Management to ensure that these have been applied to demonstrate the quality of a project proposal; even so, significant numbers of projects that are unplanned and motivated by short-term political considerations still end up being pushed onto the budget at the last moment (usually with hastily completed paperwork -the Investment Project Proposal Form). In Kosovo, although only projects that have passed through the specified PIP procedures should be eligible for budget funding, in reality, the Ministry of Economy and Finance fails to prevent a significant proportion of projects that have not followed procedures from being included in ministry submissions.

These failings arise partly because of limited internal capacities of investment units in the finance ministry, but they can also be due to the comparative weakness of the finance ministry itself in political terms as compared to some of the larger spending ministries. This seems to be the case in Serbia and Bosnia (the Federation). Often investment units do not have a firm enough mandate to challenge investment proposals, and their functions are not always well specified—are they
responsible for putting together the capital part of the budget or for ensuring that projects that are being proposed for inclusion in the budget have been properly quality controlled?

A number of the countries in the region 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 helps ensure that decision makers and legislators are aware of the forward spending implications of their expenditure choices and can maintain a tighter control 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 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 OECD countries' budgets do not necessarily provide the level of detail contained in these plans, such detail does seem appropriate to the stage of development of budgetary planning systems in the study countries.

By allowing the introduction of new projects in the middle of the year, the practice of voting on frequent supplementary budgets can undermine the discipline of the annual budget process. This is an issue in all the study countries. 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 thus absent. Often supplementary budgets, most often directed at capital spending, are voted to spend unexpected increases in revenues. 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, thus moderating one reason for frequent supplementary budgets.

In no cases are there systematic checks on implementation readiness as part of the budgetary process, which is one reason for the disappointing and uneven rates of budget execution for capital expenditure. 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—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.

In all six countries, a single finance ministry is responsible for capital and recurrent expenditure, and a unitary budget that includes both capital and recurrent spending is in place—at least on paper. In spite of these promising signs, there is still a strong tendency for recurrent and capital budgeting to be treated as separate exercises within finance ministries, with public
investment units seen as responsible for the latter. Full integration of capital is therefore still a long way from being achieved because of fragmented responsibilities within the finance ministries. The continued politicization of capital spending might be one reason why this separation persists: finance ministries (which are not necessarily very strong) may prefer to keep compartmentalized this component of the budget, which under central planning would have been under a Ministry of Economy, in order to limit political interference and potential governance problems. Even in Albania, where the budget directorate is theoretically supposed to have responsibility over budgeting, the directorate for public investment management still retains a de facto role in capital budgeting.

Weaknesses in integrated budget planning mean that the future recurrent consequences of capital expenditure decisions are rarely thought through. The issues concerning the comprehensiveness of the capital part of the budget have already been mentioned. The fact that some capital expenditure is not being adequately captured in the budget obviously compromises integrated capital and recurrent expenditure budgeting. The medium-term budgeting processes instituted across the region 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.

Project Implementation

Published Guidelines and Detailed Implementation Plans with Clear Accountability

None of the countries in the Western Balkans study had formal, centrally issued guidelines on project implementation and management arrangements, nor were detailed implementation plans with clearly delineated responsibilities for delivering projects on time, to specification and to budget the norm. The design of such arrangements is usually decentralized to implementing agencies, with varying degrees of line ministry oversight. This leads to a wide variation in the quality of project management arrangements with infrastructure-oriented directorates or agencies, for example, roads, having more reliable systems than those which undertake investment infrequently. Donor-funded projects invariably have their own management arrangements—project implementation units (PIUs) and project management units (PMUs)—running parallel to government systems. This usually means that management of specific projects is better, but the contribution to strengthening national systems by transferring skills and methods is far from optimal. Even EU-funded projects do not generally make significant contributions to the development of wider government systems. In this respect, the example of Bulgaria is informative: only in 2008, after joining the EU, did Bulgaria begin to develop comprehensive project management guidelines pertaining to all projects irrespective of funding source. This was a national initiative promoted by the finance ministry, but carried out against the background of severe criticism of planning and management arrangements for EU-funded projects where there had been significant failings.

In several countries, notably Bosnia and Macedonia, the system of setting up PIUs to implement donor-financed projects is now proving problematic. Originally established in the aftermath of the Bosnia conflict because of significant weaknesses in local systems, Bosnia’s PIUs
served the country well. However, 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 new PIUs has now been halted and there has been some consolidation, but the time has probably come to develop strategies, including remuneration policies, for absorbing the existing PIUs into ministry structures. Bosnia is probably an extreme case, but the problem was also highlighted in Macedonia and certainly exists elsewhere in the region. While there is general agreement on the principle of moving away from the PIU system, donors nevertheless remain reluctant to use country systems, particularly financial systems, in their current state.

As mentioned, Montenegro has concentrated project implementation capacities in a small number of “infrastructure” directorates. This could be a way forward for the smaller countries where existing skills are scarce and where developing them in all spending ministries might be inefficient because they would end up being relatively underutilized. For larger countries, “public works” ministries can often create more problems than they solve though.

Open Competition for Procurement and an Effective Complaints Mechanism

There is no doubt that in the area of public procurement there is a strong “EU effect” as accession candidates and potential candidates move toward transposing chapter 1, “the Free Movement of Goods,” of the *acquis communautaire* into national law and practices. The region’s laws are not yet all fully harmonized with EU directives and international good practice, but any divergences are now relatively small and gradually being rectified. There has often been technical assistance available to support these efforts.

As confirmed by annual reports by SIGMA, 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 across the region, and statistics show that in at least three countries—Bosnia, Kosovo and Macedonia—open procurement now dominates, as shown in table x.3.

Table X.3 Use of Open Procurement in the Western Balkans

<table>
<thead>
<tr>
<th>Country</th>
<th>Share of Open Procurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>49% of contracts by number (2007)</td>
</tr>
<tr>
<td>Bosnia</td>
<td>80% of contract by value (2006)</td>
</tr>
<tr>
<td>Kosovo</td>
<td>77% of contracts by value (2008)</td>
</tr>
<tr>
<td>Macedonia</td>
<td>88% of contracts by value and 81% of contracts by number (2008)</td>
</tr>
<tr>
<td>Montenegro</td>
<td>Data not available</td>
</tr>
<tr>
<td>Serbia</td>
<td>47% of all high value contracts (2006)</td>
</tr>
</tbody>
</table>

*Note:* Figures are for all public procurement and not just public investment; therefore, implications for public investment can only be inferred.
Independent complaint mechanisms have been set up in all countries, except Albania, and appear to be functioning effectively for the most part. In Albania the Public Procurement Agency is responsible for interpreting the law and giving advice to contracting authorities, as well as deciding on appeals against procurement decisions, thus creating a potential conflict of interest. Proposals for a fully independent Public Procurement Review Commission have been prepared so as to meet EU requirements.

Although the legislative framework has improved for most countries, more still needs to be done to improve implementation. Mostly this means more training of procurement officers to work in spending agencies to apply 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 because 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.

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, complex, and inflexible, though, imposing some extra costs on bidders.

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.

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 the Stabilisation and Association Agreement (SAA) and Central European Free Trade Agreement (CEFTA)—to widen the scope of tenders to regionally based suppliers so as to enhance competition.

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.

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, for example 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.

There is much interest in the six Western Balkan countries in public-private partnership (PPP) arrangements, but very few of them 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. Therefore the basis for decisions is often opaque. PPP laws drawn up thus far 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 PPPs 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 direction.

Commitment Controls and Funding Predictability

Implementation of a treasury single account (TSA) and related financial systems has been one of the more successful PFM reforms in the region, and a TSA now functions in all countries in the study. This has greatly aided financial control, including for public investment projects. Strict application of commitment controls does not seem to be commonplace though. Kosovo, however, has one of the better systems. The finance ministry requires all ministries to provide cashflow forecasts and commitment plans for capital expenditure following adoption of the budget by the assembly. No contracts may be entered into by line ministries unless there is a commitment recorded in the FreeBalance financial management system. Once a commitment has been recorded in the system, the funds are set aside and may not be used for any other purpose. Commitments must be recorded in the system, reserving funds for the project, before activity to tender for contract providers can commence.

Implementation problems from projects being cash-starved in-year were not reported for these countries, but it should be remembered that the study looked back over a period during which revenues had generally been rising faster than expected and liquidity was not generally an issue. The situation has reversed rapidly since 2009 and there are indications of cash rationing and a build-up of arrears from at least one country, Albania, and probably others.

Multiple supplementary budgets were mentioned earlier as an issue. These tended to involve additional resources for speeding up ongoing projects or starting new projects, but after
2009, this situation reversed, with ongoing projects finding their budgets reduced and new projects that are not yet contracted being put on hold. This reflects the continued position of capital spending as a residual, acting as a buffer for in-year revenue forecasting errors.

Lack of stability in medium-term budget planning is still an issue, and in all countries capital allocations for outer years of the medium-term framework remain poor predictors of actual budget allocations. This can affect implementation planning for major multi-year projects.

**Regular Progress Reporting and Active Monitoring**

Systematic and responsive monitoring is not generally being performed by finance ministries; although finance ministries often say that they expect line ministries to have their own systems in place, there are few checks to see if this is the case. What central monitoring there is tends to be infrequent, often ad hoc and passive, and concerned with financial progress only. Monitoring of physical performance is rare and feedback loops are generally missing. Whatever finance ministries may hope, there are no indications that line ministries are systematically requiring reporting from implementing agencies and actively monitoring projects. Some line ministries and spending agencies do have their own systems but, as with project management arrangements, they tend to be of variable quality.

Spending ministries are reporting on execution of their capital budgets to finance ministries at least quarterly and often monthly, but this is at an aggregate level rather than by project. Macedonia and Albania have been developing systems for reporting and monitoring progress in achieving ministry and government strategic objectives, but these systems are aimed at a higher level in the planning hierarchy than projects.

Albania has also begun monitoring financial progress against delivery of outputs by budget program. Outputs include delivery of outputs by projects, but monitoring is not at the project level. Simultaneously, the Albanian Department of Public Investment Management has been testing reporting formats for specific project monitoring, both financial and physical, but the system is still some way from being fully operational and even further from being an active monitoring process, that is, responsive to problems identified. Montenegro has one of the better reporting and monitoring systems. Quarterly reports on financial and physical execution are submitted to the finance ministry, which uses them to make adjustments in fund allocations to projects (within the limits set by the budget law). One of the functions of Kosovo’s PIP was as a monitoring tool, but so far this has been hampered by irregular and unreliable reporting. Efforts to improve monitoring at the State level were started in Bosnia (with external assistance), but it is not clear whether these will pay off, in part because of the difficulty of ensuring reliable information flows from Entity to State level in Bosnia’s complex political system.

**Sound Internal Control and Internal Audit**

Improved treasury systems in the region have provided a solid potential for sound internal control of project finances, but it is not always evident that the financial information generated is being used to its full potential to assist project managers and budget holders in the financial management of investment projects by providing timely financial information. Evidently this is the
case for those projects that are off-budget and use parallel systems, but for those projects that are on budget, treasury information systems seem capable of becoming the basis of more dynamic management tools than currently exist. In the case of Albania, apparent technical problems with the treasury system and the chart of accounts are actually impeding potential improvements to the PIM system by making it difficult to monitor larger strategic projects. Kosovo’s FreeBalance system has advanced operability, including detailed real-time, project-level reporting, but this is not being used by project managers to the full extent to manage and report on their projects. Overall, there is a long way to go in the region before financial management information systems are performing adequately enough to support project managers in the day to day management of their projects and in most countries good project managers will have their own parallel systems.

Chapter 28 of the *acquis communautaire* (JRC 2006) is concerned with financial control and encompasses public internal financial control (PIFC) and external audit. This is evidently an area where the “EU effect” could be important for PIM. The main criteria for the assessment in PIFC are the presence of the legislative framework (primary and implementing legislation), the development of the internal audit function and ex ante control mechanism throughout all the income and spending centers, as well as ensuring the functional independence of the internal auditors. PIFC is covered by the SIGMA assessment reports mentioned previously.

The EU promotes a modern approach to internal financial control that is less focused on centralized ex ante controls and ex post inspection and more on the quality and effectiveness of financial management systems and achieving economy, efficiency, and effectiveness in the use of public funds. In the countries of the Western Balkans, this approach is struggling to take hold because of a strong attachment to more traditional public internal control inherited from the days of central planning and the command economy. So, while legislative and organizational changes have been made a part of the EU integration process, it is not always apparent that these have made a fundamental difference to the approach to PIFC. The following extract from the 2009 SIGMA assessment of PIFC in Kosovo is more or less representative of the situation in much of the region (ROK 2009, 1/12):

> While progress has been made in introducing legal structures, hard evidence showing that these structures are having a significant effect on the quality of public financial management is difficult to find. For a functioning PIFC system, it is critical that the legal framework is wholly embraced by the management at all levels as a day-to-day aid in securing the efficient and effective utilization of public resources in Kosovo and that it is not viewed as an “add-on” that exists only because of European Union requirements. There is little evidence that this is the case. While financial management and control systems are being put in place and internal audit is being implemented, the levels of understanding of the technical concepts and requirements and of the standards of application generally appear to be limited. There is also some evidence that not all managers are familiar with the specific requirements of the law.

Macedonia, an EU candidate country, is performing better, but still these kinds of problems persist and although reforms have been made, including the establishment of functionally
independent internal audit units, the country is still some way from having the kind of PIFC envisaged by the European Commission. The following extract from the 2009 SIGMA assessment, which recognizes that Macedonia is still in the relatively early stages of developing its PIFC system, illustrates the problems (FRYoM 2009, 3/13):

While financial management and control systems are being put in place and internal audit is being implemented (but so far not in all public organizations that are required to appoint internal auditors), the levels of understanding of the technical concepts and requirements as well as the standards of application generally appear to be limited. There is also some evidence of a degree of “literality” in the interpretation of the legal requirements, which suggests that not all heads of organizations (or indeed internal auditors) understand what the objectives of the law really are.

So, while there is a definite EU effect in the area of internal control and internal audit of public investment, the effect seems so far limited to establishing basic financial control systems—not an insignificant development in itself!—and to initiating legal and organizational structures for internal audit, with considerable work still to be done to make these structures functional.

**Formal Project Completion**

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 during project implementation. This results in either a lower quality of works than specified in the contracted design, or significant cost overruns because of spurious variation orders, or because of underbidding by contractors, knowing that they will be able to manipulate works supervisors.

Serbia, Montenegro, and Macedonia have passed laws governing spatial planning and construction that still bear a strong resemblance to the law that pertained in the Former Yugoslavia. These laws require technical inspection of completed projects to ensure that they have been built according to the specification and quality set out in the contracted design. These inspections are carried out by registered experts who must not have participated in preparing the project or in supervising its implementation. A positive inspection is required before a utilization permit can be issued allowing the owner of the newly created asset to occupy and begin using it. Albania, Kosovo, and Bosnia also have similar requirements.

Therefore, on paper there is a formal project completion step. As with supervision of works, there is a suspicion that this can sometimes just be a “rubber-stamping” exercise.

While concerns have been expressed in the region about the integrity of supervision and formal project completion processes, there is no reason to believe that these problems are worse here than elsewhere. Indeed, the overall impression of the region is that project implementation is probably one of the stronger areas of the PIM system and that the major weaknesses lie in pre- and post-implementation.
Adjustment for Changes in Project Circumstances

Adjustment for changes in project circumstances, particularly demand-side factors, is generally absent from PIM systems across the region. Systems for identifying poorly performing or failing projects and explaining variances from plan are not well developed (see previous section, Regular Progress Reporting and Active Monitoring) and, even where information on such projects is known, formal mechanisms for project adjustment are missing. Adjustment to changed technical conditions is possible when proposed by a contractor, verified by the supervising engineer, and approved by project management, but this is not the same as downscaling or re-designing to meet lower than expected demand or other changed demand conditions. Weaknesses in project appraisal mean that benefits are rarely estimated (for domestically funded projects), making periodic review of benefits relative to costs difficult. Halting projects because of changed demand or technical conditions is virtually unheard of.17

Facility Operation

As indicated earlier, all countries in the study had formal project completion processes involving inspection of the assets and, in the cases of Serbia, Macedonia and Montenegro, issuance of a permit to allow use of the verified asset. So, on paper there is an “effective handover of assets”; in practice, though, concerns exist about the impartiality of some of the participants and, therefore, whether the systems consistently ensure the “delivery of assets fit for purpose.”

Asset registers are not universal, and where they do exist there are problems maintaining them. Macedonia, Montenegro, and Bosnia have asset registers, but entry of new assets is not always done systematically or accurately. Serbia and Albania seem to be missing asset registers, and in Kosovo some organizations have asset registers and others do not. Montenegro has recently begun a project to establish systems to ensure that new assets with accurate valuations are consistently recorded in registers.

There is no doubt that maintenance expenditure is generally underfunded across the region, although it may not be as significant a problem as in other regions where investment is predominately donor-financed through a separate development budget. It has been estimated that Albania, for example, has been spending 40 percent less on maintenance of the national road network than is needed (World Bank 2006) and Kosovo seems to be performing similarly (World Bank 2006). In spite of moves in the right direction, recurrent and capital budgeting tends to be fragmented and the recurrent spending implications of investment are not systematically taken into account. In Kosovo, for example, recent increases in investment have not been matched by corresponding increases in recurrent funding of operations and maintenance and a gap has been opening up.18 Another factor is that periodic maintenance (“heavy maintenance”) is generally classified as capital expenditure and must compete against new capital spending initiatives in the budget process, rather than being considered as an ownership obligation.

Ex Post Assessment

Outside of donor requirements, ex post assessment of public investment projects is systematically weak in the region and a basic comparison of project costs, timelines, and
deliverables against budgets and plan is rarely undertaken. While it is important to begin developing such an assessment system, initially this may not seem to be as important as other areas of public investment management. In such a system, both monitoring and evaluation require an effective project planning system to be in place first so that there are baseline plans and performance measures against which to assess progress and project success. In the absence of these, it becomes difficult to institute formal arrangements for project evaluation against plan and appraisal. Evidently, with no formal evaluation arrangements in place, responsiveness to evaluation findings is equally weak. Even when donors undertake evaluations, the systems are not in place for governments to learn from these and build the findings into design and implementation of future projects, both externally and domestically funded.

All the same, it is evident that this is an area where more work is now required in all six countries to take the first steps in establishing a prototype assessment process, even if the initial focus has to be limited to implementation performance against plan (financial, timelines, and quantity and quality of contracted deliverables), and explanations for any deviations, rather than an ex post assessment of wider project performance, in achieving the project purpose at reasonable cost (that is, assessment of effectiveness or value for money), which is probably some way off. A “bare-bones” assessment system like this could be one way of stimulating demand for better project appraisal and implementation and could be a possible entry point for PIM reform.

Stimulated by the demands of the EU integration process,19 supreme audit institutions (SAI) have now been set up everywhere, often with significant external support, but none are yet carrying out performance audits (effectiveness or value for money audits) of public investment projects. The effectiveness of the various SAIs varies significantly among countries, depending on how long they have been in existence and how well they have been resourced. Sometimes SAIs have been deliberately under-resourced (for example, in Serbia), and their independence is not always firmly established (for example, in Macedonia). Most of their work consists of basic compliance audits, but capacities to carry out financial audits are increasing and 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. Overall there is probably a positive EU effect, with Macedonia, a candidate country, having a better resourced and more effective SAI than the aspiring candidates at the time of the study. Even so, Macedonia still has some way to go before the SAI is fully compliant, as the 2009 SIGMA assessment report indicates (FYRoM 2009). One of the weakest areas in all countries is responsiveness to audit findings.

None of the countries seems to be close to having its 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, although some in-house skills would still be required (for example, to prepare terms of reference and interpret audit findings). SAIs could also be responsible for verifying and reporting on whether the bare-bones assessment described above has been carried out. Both these approaches could be ways of
stimulating the demand for improvements to PIM systems, particularly via pressure from legislatures.

**Conclusions, Potential Areas for Further Work, and the “EU Effect”**

All countries in the region now have public investment (PIM) units located in their finance ministries, but their capacities are generally weak and their roles often not well defined. Therefore, there is still scope for identifying specific 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.

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.

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 one way of promoting their adoption.

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 (resulting in low rates of capital budget execution). There is scope for looking further into this issue and for developing firmer proposals for tightening up budget preparation procedures.

Public-private partnerships, particularly concession 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: therefore, 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 was only been able to take a superficial look at this area and there is more probing to be done in all six countries.

The practice of voting mid-year supplementary budgets seems to be common in the region and seems to impact disproportionately on capital spending. Recently 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.

Concern was 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.

Ex post assessment 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. Therefore, further work is 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. Introduction of a more systematic analysis of outturn compared to plan upon project completion could be one means of generating demand for wider improvement to the PIM system. Some well-targeted, one-off evaluations of problem projects, either by government or by the supreme audit institution, could also act as a stimulus for the improvements in planning mentioned. More involvement of the SAI could stimulate the legislature in pushing for deeper consideration of value-for-money issues. Civil society could potentially also play a stronger role in holding government to account—in criticizing the quality of appraisal of large projects, in monitoring physical implementation of projects, in monitoring irregularities, in reviewing post-completion asset utilization—but suffers from being relatively under-developed, particularly when it comes to organizations focusing on public expenditure management.

The World Bank study (World Bank 2010) 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, their investment decisions can interact significantly with public budgets in different ways depending on the country, for example, by creating large contingent liabilities, through direct subsidies or transfers they might receive for investment purposes, or via government on-lending for investment. The study did not examine this wider class of issues; however, in future work it might be worth doing so, perhaps in a specific sector/country context.

Finally, the view of the PIM systems presented in the study is largely drawn from experience over a period of unprecedented growth and revenue over performance. This has now turned into a period of marked slowdown. What was a pattern of over-reaching and under-fulfillment of capital budgets has now given way to severe mid-year cuts in capital spending, which is often treated as a “residual.” This indicates the need for reinforced efforts to improve revenue forecasting—so that there are fewer “surprises” midway through the budget year with
disproportionate impacts on capital spending—to respect the integrity of the annual budget cycle, that is, limit the frequency of supplementary budgets, and to make hard choices about investment priorities rather than spreading resources too thinly over too many projects.

One of the interesting aspects of the study is the light it sheds on a potential “EU effect” on PIM systems in the Western Balkans region where all countries are aspiring EU members. As the discussion indicates, there is an identifiable effect, but it is rather narrowly focused on areas that are the concern of the *acquis communautaire*, that is, public procurement, public internal financial control, and external audit. To a certain extent there is also an impact on strategy development, although this is highly variable between countries.

All countries are moving forward in these areas with the aim of harmonizing their approaches with those of EU members, and some countries, like Macedonia (and Croatia), are further advanced than the others. However, in terms of improving project planning and appraisal to encompass value-for-money considerations, the EU effect is much more limited, being confined to EU-funded projects only, with little cross-fertilization to domestically funded investment.

Croatia’s experience (see box x.4) illustrates the continued weaknesses of a country that is now an EU member. The case of Bulgaria is also instructive in this respect: only after joining the EU did the country start to take decisive steps to introduce systems for ensuring that all public investment, from whatever funding source, would be subject to the same rigorous appraisal processes. Romania, too, joined the EU with a weak emphasis on value for money in spite of extended support in this area, beginning with an EU-funded project in 1996. Experience in the region therefore reveals that the EU integration process has exerted only a weak effect on this fundamental dimension of PIM systems. Partly this is a reflection of the priorities of the *acquis communautaire* and partly it illustrates how difficult it is impose a value-for-money culture on an administration from the outside.

In spite of these reservations about the strength the EU effect, there has been genuine progress in the Western Balkans compared to experience in other regions, even if across a narrower front than might initially have been expected. EU integration ambitions and the associated harmonization requirements provide an impetus for reform that is missing elsewhere, and the fact that progress is regularly monitored helps reinforce incentives. Adoption of the *acquis* might sometimes seem like a mechanical approach to reform but when accompanied by relevant and innovative technical assistance, for example, carefully designed twinning arrangements as in Macedonia’s case, it seems to outperform more traditional technical assistance approaches.

The study documented in this chapter was designed as a diagnostic overview of the region aiming to provide provisional recommendations only and to identify areas for deeper analysis. A second phase of work had originally been envisaged, but it fell victim to financial constraints.
Notes

1. The design of the questionnaire drew on the following four sources: (1) Rajaram et al. 2008; (2) Background research questionnaire for World Bank 2007; (3) Self-completion questionnaire used at the Istanbul Workshop on Experiences in Public Investment Management, organized by the World Bank in February 2008; and (4) Bird 2007.

2. The Albanian Government borrowed €230 million through a syndicated loan used largely to finance a major road project.

3. Almost certainly too comprehensive—there are nearly 40 sector strategies and cross-cutting strategies and an exercise is under way to streamline them.

4. For example, the transport sector has had substantial external technical assistance, including support in preparing a transport sector master plan. Within transport, the roads subsector has had continuous technical assistance since 1996 and has built a firm basis for strategic investment planning. The planning basis in other sectors is less firm.

5. EU Member States must produce "National Development Plans" (or their equivalent) to obtain Structural Funds, but these are often regional development plans rather than overarching national plans. This is the case for the UK.

6. Canada, Australia, and New Zealand now have national infrastructure plans. Sweden has a national transport strategy. The UK has a national infrastructure strategy.

7. Often these laws require that projects should be in conformity with spatial and urban plans. Since these plans are often out of date, this requirement can cause problems. Sometimes it means delays while spatial and urban plans are updated, for example, as in Macedonia; sometimes spatial and urban plans are updated “after the fact” to reflect project decisions, for example, in Montenegro.

8. The pre-2009 law had been supplemented by a regulation stipulating the contents of feasibility studies, which explicitly included economic feasibility, but since the primary legislation did not mention economic justification, this secondary legislation carried little weight.

9. Interestingly, Bulgaria, a new EU Member State, failed to make this distinction when it adopted EU guidelines on project appraisal for domestically funded projects. Also interesting is that Bulgaria did not do this until after accession.

10. This was still a problem in Bulgaria when it started to develop guidelines after accession to the EU.

11. At the time of the study, a much higher threshold was being considered, with a feasibility study and CBA only being required for projects above €15.0 million. This has since been reconsidered.

12. Bosnia is the only country in the region where multi-year contracting can be problematic.
13. The SBMG comprises senior representatives of the Ministry of Finance, the Department of Donor Coordination at the Council of Ministers, and the Ministry of European Integration.

14. These are not always labelled MTEF; for example, Albania’s MTEF is known as the “Medium Term Budget Programme.”

15. SIGMA – Support for Improvement in Governance and Management, a joint initiative of the OECD and EU—carries out annual reviews of key areas of PFM and policy making, including public procurement, as inputs to the EU’s annual progress reports on progress towards accession. The assessments are conducted against sectoral baselines developed by SIGMA and the EC. They cover the following sectors: civil service, administrative legal framework, public integrity, public expenditure management, public internal financial control, external audit, public procurement, and policy-making and coordination. Each year the EC prioritizes the sectors to be assessed.

16. From EC 2006, 5: “Usually, the more traditional systems of public internal control are based on a system of centralized ex ante control and ex post inspection that focus on third-party complaints, questionable transactions, violations of budget rules (no matter how trivial or how unavoidable in specific circumstances), and punishing human error. Compared to modern systems of public internal control, the traditional system—with its emphasis on legality and regularity—lacks the criteria of economy, efficiency, and effectiveness in relation to managing and controlling public funds. Modern internal control is focused on transparency, both in terms of clear lines of responsibility and harmonized methodology and standards. Transparency is a manifestation of the principle of the government being held accountable towards the public that has elected it to raise income and spend on its behalf.”

17. The countries in the study do not appear to suffer from the problem of “hangover” projects from the pre-transition period, though. This has been a problem in other countries in the Balkans. Bulgaria, for example, still had “ongoing” projects from the 1980s on the books in 2008. These had proved very difficult to kill off.

18. Using $r$ coefficients, the 2006 PEIR estimated an additional recurrent expenditure need of US$8 million from the 2004 investment program alone.

19. Chapter 28 of the acquis communautaire dealing with Financial Control has specific requirements concerning external audit: the need for independence (financial and in terms of audit planning and methods), comprehensive coverage of all public spending no matter what the funding source, and the need for mechanisms to ensure responsiveness to audit findings.
References


The design of the questionnaire drew on the following four sources: (1) Rajaram et al. 2008; (2) Background research questionnaire for World Bank 2007; (3) Self-completion questionnaire used at the Istanbul Workshop on Experiences in Public Investment Management, organized by the World Bank in February 2008; and (4) Bird 2007.

The Albanian Government borrowed €230 million through a syndicated loan used largely to finance a major road project.

Almost certainly too comprehensive—there are nearly 40 sector strategies and cross-cutting strategies and an exercise is under way to streamline them.

For example, the transport sector has had substantial external technical assistance, including support in preparing a transport sector master plan. Within transport, the roads subsector has had continuous technical assistance since 1996 and has built a firm basis for strategic investment planning. The planning basis in other sectors is less firm.

EU Member States must produce “National Development Plans” (or their equivalent) to obtain Structural Funds, but these are often regional development plans rather than overarching national plans! This is the case for the UK.

Canada, Australia, and New Zealand now have national infrastructure plans. Sweden has a national transport strategy. The UK has a national infrastructure strategy.

Often these laws require that projects should be in conformity with spatial and urban plans. Since these plans are often out of date, this requirement can cause problems. Sometimes it means delays while spatial and urban plans are updated, for example, as in Macedonia; sometimes spatial and urban plans are updated “after the fact” to reflect project decisions, for example, in Montenegro.

The pre-2009 law had been supplemented by a regulation stipulating the contents of feasibility studies, which explicitly included economic feasibility, but since the primary legislation did not mention economic justification, this secondary legislation carried little weight.

Interestingly, Bulgaria, a new EU Member State, failed to make this distinction when it adopted EU guidelines on project appraisal for domestically funded projects. Also interesting is that Bulgaria did not do this until after accession.

This was still a problem in Bulgaria when it started to develop guidelines after accession to the EU.

At the time of the study, a much higher threshold was being considered, with a feasibility study and CBA only being required for projects above €15.0 million! This has since been reconsidered.

Bosnia is the only country in the region where multi-year contracting can be problematic.
Public Investment Management and the EU Effect

The SBMG comprises senior representatives of the Ministry of Finance, the Department of Donor Coordination at the Council of Ministers, and the Ministry of European Integration.

These are not always labelled MTEF; for example, Albania’s MTEF is known as the “Medium Term Budget Programme.”

SIGMA – Support for Improvement in Governance and Management, a joint initiative of the OECD and EU—carries out annual reviews of key areas of PFM and policy making, including public procurement, as inputs to the EU’s annual progress reports on progress towards accession.

The assessments are conducted against sectoral baselines developed by SIGMA and the EC. They cover the following sectors:
civil service, administrative legal framework, public integrity, public expenditure management, public internal financial control, external audit, public procurement, and policy making.

Each year the EC prioritizes the sectors to be assessed.

From EC 2006, 5: “Usually, the more traditional systems of public internal control are based on a system of centralized ex ante control and ex post inspection that focus on third party complaints, questionable transactions, violations of budget rules (no matter how trivial or how unavoidable in specific circumstances), and punishing human error. Compared to modern systems of public internal control, the traditional system—with its emphasis on legality and regularity—lacks the criteria of economy, efficiency, and effectiveness in relation to managing and controlling public funds. Modern internal control is focused on transparency, both in terms of clear lines of responsibility and harmonized methodology and standards. Transparency is a manifestation of the principle of the government being held accountable towards the public that has elected it to raise income and spend on its behalf.”

The countries in the study do not appear to suffer from the problem of “hangover” projects from the pre-transition period, though. This has been a problem in other countries in the Balkans. Bulgaria, for example, still had “ongoing” projects from the 1980s on the books in 2008. These had proved very difficult to kill off.

Using r" coefficients, the 2006 PEIR estimated an additional recurrent expenditure need of US$8 million from the 2004 investment program alone.

Chapter 28 of the "acquis communautaire dealing with Financial Control has specific requirements concerning external audit: the need for independence (financial and in terms of audit planning and methods), comprehensive coverage of all public spending no matter what the funding source, and the need for mechanisms to ensure responsiveness to audit findings.”