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MALAWI

August 2018

TECHNICAL ASSISTANCE REPORT—PUBLIC INVESTMENT MANAGEMENT ASSESSMENT (PIMA)

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FISCAL AFFAIRS DEPARTMENT

Malawi

Public Investment Management Assessment

Richard Allen, Racheeda Boukezia, Lewis Murara, Graham Smith, Amitabh Tripathi

Technical Assistance Report | June 2018

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F I S C A L   A F F A I R S   D E P A R T M E N T

Malawi
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ACRONYMS

AER	Annual Economic Report
AFRITAC	African Regional Technical Assistance Center
BD	Budget Division
CCA	Credit Ceiling Authority
COST	Construction Sector Transparency Initiative
DFI	Development Finance Institution
ECF	Extended Credit Facility
EFPS	Economic and Fiscal Policy Statement
EP&D	Economic Planning and Development
EGENCO	Electricity Generation Company
ESCOM	Electricity Supply Commission of Malawi
EU	European Union
FAD	Fiscal Affairs Department
FRL	Fiscal Responsibility Law
GEF	Global Education Fund
GPE	Global Partnership for Education
IFMIS	Integrated Financial Management Information System
IPDF	Infrastructure Project Development Fund
IMF	International Monetary Fund
JICA	Japanese International Cooperation Agency
LGA	Local Government Act
LGFC	Local Government Finance Committee
LDF	Local Development Fund
LIDC	Low Income Developing Country
MDA	Ministry, Department, and Agency
MGDS	Malawi Growth and Development Strategy
MACRA	Malawi Communications Regulatory Authority
MAPS	Methodology for Assessing Procurement System
MERA	Malawi Energy Regulatory Authority
MESIP	Malawi Education Sector Improvement Program
MoFEPD	Ministry of Finance, Economic Planning, and Development
MoNREM	Ministry of Natural Resources, Energy and Mining
MRA	Malawi Revenue Authority
MTEF	Medium-Term Expenditure Framework
MTFF	Medium-Term Fiscal Framework
NAO	National Audit Office
NPC	National Planning Commission
OECD	Organization for Economic Cooperation and Development
PFMA	Public Finance Management Act
PIMA	Public Investment Management Assessment

PPDA	Public Procurement and Disposal of Assets Authority
PPP	Public Private Partnership
PPPC	Public Private Partnership Commission
PSIP	Public Sector Investment Program
RBM	Reserve Bank of Malawi
SAPP	Southern African Power Pool
SATTFP	Southern African Trade and Transport Facilitation Project
SMO	Single Market Operator
SOE	State-Owned Enterprise
SSA	Sub-Saharan Africa
SWG	Sector Working Groups
WRB	Water Resources Board

PREFACE

In response to a request by the Secretary to the Treasury of the Ministry of Finance, Economic Planning and Development (MoFEPD), a mission from the Fiscal Affairs Department (FAD) of the International Monetary Fund visited Lilongwe during the period April 25-May 8, 2018 to conduct a Public Investment Management Assessment (PIMA) and advise the government on improving management practices for public investment. The mission was led by Richard Allen (FAD) and included Racheeda Boukezia and Lewis Murara (both FAD), Amitabh Tripathi (PFM Advisor, East AFRITAC), and Graham Smith (FAD expert).

The mission met with the Minister of Finance Hon. Goodall Gondwe; the Secretary to the Treasury, Mr. Ben Botolo; Acting Chief Director of the Economic Planning and Development (EPD), Mr. Peter Simbani; Accountant General, Mr. Chrighton Chimombo; Budget Director, Mr. Peterson Ponderani; Director of PEFM, Mr. Hetherwick Njati; and Deputy Director of Debt and Aid, Mr. Dave Wilima. Technical discussions were held with several other senior officials in the MoFEPD. Outside the Ministry of Finance, the mission met with the Auditor General, Mr. Stephenson Kamphasa; Acting Director of the Public Procurement and Disposal Authority, Mr. Arnold Chirwa; Chief Director of the Performance Enforcement Department in the Office of the President and Cabinet, Mr. Dickson Chunga; Permanent Secretary of the Ministry of Information, Mrs. Erica Maganga; and Commissioner of the National Planning Commission, Dr. Graham Chipande. The mission also met with senior officials from the Ministries of Agriculture, Natural Resources and Energy, Health; Transport and Public Works; Education, Science and Technology; Local Government and Rural Development; the Department of Statutory Corporations in the Office of the President and Cabinet; the Roads Fund Administration; the Roads Authority; the National Local Government Finance Committee; the Lilongwe City Council; the Lilongwe Water Board; the Malawi Energy Regulatory Authority; and the Malawi Comm. Regulatory Authority.

In Blantyre, the mission met with the CEO of the Electricity Generation Company (EGENCO), Mr. William Liabunya; the CEO of the Electricity Supply Commission of Malawi (ESCOM), Dr. Allexon Chiwaya; the CEO of the Public Private Partnership Commission, Mr. Jimmy Lipunga; and the CEO of the Blantyre City Council, Dr. Alfred Chanza. The mission also met with the Chairperson of the Parliamentary Budget Finance Committee Mr. Rhyino Chiphiko, and its members. The mission held discussions with the representatives from the World Bank, the European Union, the Japanese International Cooperation Agency (JICA), the UK Department for International Development, and Deutsche Gesellschaft fur Internationale Zusammenarbeit (GIZ) on potential areas for collaboration in strengthening public investment management in Malawi. The World Bank provided helpful drafting suggestions on the mission's report.

The mission would like to thank the authorities for the frank discussions, and courtesy extended throughout its stay. Special thanks to Ms. Chikondi Phiri, Economist and Mr. Jollam Banda, Deputy Director EPD, for their excellent logistical support. The mission appreciates the guidance and support provided by Mr. Jack Ree, the Resident Representative, and Mrs. Audrey Kumwenda and Mrs. Susan Zimba of the IMF office in Lilongwe.

EXECUTIVE SUMMARY

The government has highlighted infrastructure development as a key element of the Malawi Growth and Development Strategy (the MGDS), and has acknowledged the associated fiscal risks. Increasing public investment has also been highlighted in the government's new Extended Credit Facility (ECF) program with the IMF. In the period 1990–2015 public investment averaged about 5.5 percent of GDP. In recent years more than 85 percent of this investment has been externally financed. Spending by local authorities represents only between 1.0 and 1.5 percent of the domestically-financed component of public investment. The emphasis on increased public investment needs to be balanced against potential fiscal risks related to future public-private partnerships, several of which are in the pipeline, and other contracts, including with the bilateral donors and private sector partners, on which little information has been made publicly available. Such risks may negatively impact on the government's debt management strategy and its fiscal stabilization policy.

Since the 1990s, public investment in Malawi has generally been lower than in low-income developing countries (LIDCs) in the sub-Saharan African (SSA) region and elsewhere. Investment has tended to be volatile compared to neighboring countries. The nominal public capital stock is in line with the average for LIDCs and SSA countries. The number of public-private partnerships (PPPs) has been very small in recent years, but several large projects, mainly in the education, energy and water sectors, are in the pipeline. The perceived quality of infrastructure is relatively low, as are measures of infrastructure access and service delivery in education, roads, and electricity, but Malawi performs quite well on indicators for health and access to treated water.

Measured against the overall strength of its public investment management (PIM) institutions, Malawi performs broadly in line with other LIDCs and SSA countries, but less well than better-performing emerging markets. Measures of institutional strength show how well Malawi rates in terms of its existing laws and regulations, as well as the formal guidelines and instructions issued by the government to implement these laws. The PIMA diagnostic tool also measures how effectively, in practice, the government implements and enforces these laws and regulations. On this measure of effectiveness, Malawi performs relatively poorly.

Looking at individual indicators of PIM, Malawi's performance is mixed (Table 1). On the positive side, performance is relatively strong in areas such as the country's comprehensive national planning system, coordination between central and local government, the comprehensive Public-Sector Investment Program (PSIP) which is a well-designed platform for portfolio management and monitoring, and well-enforced restrictions on moving budget funds from capital to recurrent spending. The Accountant General has also started an initiative which would eventually create a comprehensive register of the government's non-financial assets.

On the less positive side, there are several PIMA indicators where the rating is relatively weak. These include failure to apply cost-benefit analysis systematically to large projects; significant gaps in the data published in the budget documents on capital investment costs and multiyear contracts; unpredictability in the funding of capital projects, and their vulnerability to in-year budget cuts; weaknesses in cash management which have contributed to the huge build-up of arrears for both recurrent spending and capital projects; lack of effectiveness and transparency in the procurement process; weaknesses in the management and implementation of projects; and lack of effective monitoring, evaluation and oversight of large projects.

It should be noted that the results of the PIMA may understate the overall quality of PIM, looking across all public investment projects in Malawi. This report focuses primarily on the performance of domestically-financed investment projects which, as noted, represent only a small share of total public investment. Externally-financed projects are generally subject to much higher standards of management, based on the donors' internal procedures and standards. For example, large projects financed by the development partners are typically subject to rigorous feasibility studies and cost-benefit analysis, detailed implementation plans, and project implementation through dedicated project units. If the good practices associated with externally-financed projects were considered in the PIMA assessment, Malawi's overall rating would be higher.

Improvements in PIM institutions will require revisions to the PFM Act (PFMA) and other legislation—the report makes specific suggestions for legal changes—as well as a sustained capacity building effort. Specific recommendations are summarized in Table 2. Technical assistance has already been provided by FAD and AFRITAC-East in the areas of commitment controls, cash management, and arrears management, and these interventions will yield benefits for the planning and predictable financing of PIM. Other development partners such as the EU, the Japanese International Cooperation Agency (JICA), and the World Bank have contributed to the building of technical systems and human capacity in areas such as the PSIP and procurement. Further support will be required to enhance the functionalities and operations of the PSIP, as well as in areas such as procurement, project appraisal, and the monitoring and evaluation of investment projects.

Many of the changes recommended in this report are quick wins and would be relatively easy to implement. Examples include improvements in budget documentation on capital projects, data for which already exist, and bringing forward the date of issuance of the budget ceilings for line ministries. Estimates included in this report suggest that, if the government were to implement these suggested reforms, Malawi's overall PIMA rating would increase substantially by 2022, and could exceed the level achieved by many emerging markets in Africa and other regions. Table 1 summarizes the PIMA scores, and Table 2 provides a list of recommendations, highlighting those which should be given priority to generate quick wins, and enable broad-based improvements in PIM practices and performance.

Table 1. Malawi: Summary Assessment

Phase / Institution			Institutional Strength	Effectiveness	Rec.
A. Planning	1	Fiscal targets and rules	**Medium:** Fiscal policy is guided by fiscal principles in the PFMA, a MTFF updated every, year and there is a limit on central government domestic debt	**Medium:** The fiscal principles in the PFMA are too broad. But fiscal policy is de facto constrained through the fiscal rules/targets defined in the ECF program	
	2	National and sectoral planning	**Medium:** National and sector strategies include measurable targets and cost estimates for major projects but are not financially-constrained	**Low:** Investment decisions on government-funded projects are cash-constrained, but cost estimates are unreliable	
	3	Coordination between entities	**Medium:** Capital spending by districts is coordinated with central government, and a rule-based system for capital transfers is used	**Medium:** Contingent liabilities on domestically-financed capital projects developed outside the PSIP and PPP frameworks, are not comprehensively assessed	
	4	Project appraisal	**Low:** Project appraisals are conducted using different methodologies. They do not always systematically assess risks	**Low:** In most cases, analysis is absent or weak, but varies depending on sector and source of funding, thus affecting decision-making	1,2,3
	5	Alternative infrastructure provision	**Medium:** There is competition in most economic infrastructure sectors, including for PPPs, but oversight of SOEs' investment plans and financial performance is not adequate	**Medium:** Some SOEs provide data on financial performance in their annual financial statements. Regulatory agencies do not enjoy full independence	4
B. Allocation	6	Multi-year budgeting	**Medium**: Medium-term spending projections of development spending are provided for the budget year and two outer years, and ceilings are allocated to MDAs	**Low:** Spending ceilings are indicative, vary widely, and are provided too late in the budget process; data on total project cost and their annual breakdown are not provided	
	7	Budget comprehensive-ness and unity	**Medium:** Development and recurrent budgets are prepared, disclosed and approved together under a program classification, with information also on parastatals' and off-budget spending	**Medium:** While SOEs contribute to national investment, and PPPs are expected to increase, no information on SOEs' capital investment, nor on PPPs is disclosed in the budget documentation	6,7
	8	Budgeting for investment	**Medium:** Outlays are appropriated for the annual budget but multi-year commitments are not disclosed. Ongoing projects are prioritized, and capital spending is protected from virements	**Low :** New projects are often included in the budget at the expense of ongoing projects, which can be underfunded, causing large arrears. No reports on in-year changes in capital allocations are published	7
	9	Maintenance funding	**Medium:** Maintenance expenditure is identified in the budget, but is not estimated using a standard methodology except for the roads sector	**Low:** Maintenance funding is inadequate, prone to fluctuations and vulnerable to in-year cuts in face of funding pressures	8
	10	Project selection	**Medium:** Most major projects are not subject to detailed central review, but all projects are subject to basic appraisal through the PSIP process	**Medium:** The PSIP Unit makes the final decision on project selection, but decisions are subject to administrative/political review	5
C. Implementation	11	Procurement	**Low**: Only 25 percent of tenders go through an open and competitive process, and there is no procurement database	**Low:** Limited procurement data on tenders and contract awards are published, and the complaint review process is neither transparent nor effective	9
	12	Availability of funding	**Low:** Cash flow plans are neither reliable nor updated, and prudent project planning is also undermined by cash rationing	**Low:** Cash forecasting practices are basic. Unannounced budget cuts and funding constraints result in many MDAs receiving less their allocated budget	10
	13	Portfolio management & oversight	**Medium:** Central oversight of implementation is weak. Funds can be reallocated between projects, but not using systematic monitoring and transparent procedures	**Low:** MDAs do not regularly update the PSIP database with information of physical and financial progress of projects. Ex-post reviews are not conducted systematically	11
	14	Project management	**Low:** Most projects have dedicated project managers and units, but implementation plans are prepared too late	**Low** There are no standardized rules and procedures for project adjustments. Ex-post audit reports are not publicly available	11
	15	Monitoring of public assets	**Medium:** MDAs are required to prepare and maintain asset registers, which would supplement the government's cash-based accounts	**Low:** Few MDAs maintain asset registers, and NAO has frequently reported weak asset management practices	12

Table 2. Malawi: Summary of Recommendations

Phase of PIM	Recommendation [1/]	Inst.	TA need
A. Planning Sustainable Levels of Investment	**1. Develop standard guidelines on project appraisal to support the PSIP process** • Update the current PSIP manual with an additional guidance on project appraisal (EP&D, December 2019) • In coordination with the PSIP Unit, MDAs should update their sector strategies with information on the lifecycle costs, outputs and outcomes of priority projects (MDAs, December 2019)	4	✓
	2. Establish an Infrastructure Project Development Fund (IPDF) or comparable financing for MDAs and the PPPC through the budget • Develop operating procedures and practices for the IPDF (PSIP Unit and PPPC Secretariat, December 2018)	4	✓
	3. Update the PFMA, specifically with respect to project appraisal and selection • Include a provision that mandates all capital projects be recorded in the PSIP database (EP&D, PFM Reform Coordination Unit, November 2018) • Include a provision that mandates all major capital projects above a defined threshold (+/-US$ 100 million) to be subject to CBA (EP&D PFM Reform Coordination Unit, November 2018)	4&10	X
	4. Strengthen the MoFEPD's role in the financial oversight of SOEs' investment activities and financial performance • Include a provision in the revised PFM Act on the financial oversight of SOEs, and strengthen the unit within MoFEPD (Public Enterprise Monitoring Unit, November 2018) • Prepare a consolidated report on the investment activities and financial performance of SOEs, and associated fiscal risks (Public Enterprise Monitoring Unit, December 2019)	5	✓
B. Allocating Investment	**5. Give more authority to MDAs in the selection of priority projects to be included in the budget** • MDAs' expenditure ceilings should be set at the time of the strategic budget hearings in November to allow them to prioritize capital projects which are not externally financed. Ceilings could be adjusted in line with the MTEF prepared later (BD/EPD, November 2018)	6&10	X
	6. Expand the budget documentation to capture all public investment projects • Improve the information on "off-budget" expenditures in consultation with the NGOs/bilateral donors who implement these projects; and break down expenditure between development and recurrent spending (BD/EPD; June 2019) • Develop reporting mechanisms for PPP projects by MDA, including data on guarantees and other contingent liabilities (BD with the assistance of the PPPC; December 2019). • Publish financial reports on SOEs, covering their financial status and investment activities, and any budget support, loans, and guarantees received (BD/Accountant General/ Department of Statutory Corporations, OPC, June 2020)	7&8	✓

[1/] Note: The six recommendations highlighted in blue are those to which the authorities could give special priority, will generate quick wins, and enable broad-based improvements in PIM practices and performance.

Table 2. Malawi: Summary of Recommendations (concluded)

	7. Include information on total project costs and multiyear commitments in the budget • Publish in the budget information on (i) total estimated project costs; (ii) previous budget years' actual spending; (iii) estimated spending in the current budget year; (iv) committed expenditures for the next budget year; (v) estimated spending and contractual commitments for the MTEF outer-years; and (vi) the balance of funding required to complete each project (BD/EPD-PSIP unit; March 2019)	6,7,8	X
	8. Revise existing processes for estimating and disclosing information on maintenance requirements and costs • Develop standard guidelines on the estimation of maintenance requirements and their cost, and prevent their reallocation during budget execution (EP&D in collaboration with the BD, December 2019) • Provide more consistent information in budget execution reports and the annual financial statements on maintenance spending (BD, June 2020)	9	✓
C. Implementing Investment	**9. Prepare a detailed implementation plan for improving the transparency of the procurement process** • Publish information on procurement activities and analytical reports to comply with the new law (PPDA, October 2018) • Ensure independence and transparency of the complaint review mechanisms, and regularly publish information on the outcome of specific cases (PPDA, December 2018) • Conduct regular procurement reviews/audits in close collaboration with the National Audit Office (PPDA, June 2019)	11	✓
	10. Ensure that funding for capital spending is made available in a consistent and timely manner • Improve cash flow forecasting to include committed expenditures for the current and future years (BD, October 2018) • Move from monthly to quarterly cash releases for selected capital expenditure categories (BD, July 2018). • Inform MDAs sufficiently in advance of upcoming and anticipated spending cuts (BD, July 2018)	12&13	✓
	11. Increase the usefulness of the PSIP database as a platform for the oversight and monitoring of investment projects • Undertake an independent audit of the existing PSIP with a focus on expanding its coverage and effectiveness, increasing the regularity and timeliness of MDAs quarterly reports on capital projects, enhancing the functionality of the PSIP by tracking progress against total project outcomes and costs, and reconciling information in the database with the selection of projects in the budget (EP&D, June 2019) • Ensure that the technical specifications for the new IFMIS provides for interfaces with the PSIP and the aid management platform (EP&D, October 2018) • Pilot ex-post reviews/audits of major capital projects in collaboration with the NAO (EP&D, June 2019) • Publish a consolidated annual financial report on major capital projects (EP&D, June 2019)	Cross-cutting	✓
	12. Improve reporting on non-financial assets • Require MDAs to maintain and update a register of the stock and value of non-financial assets (Accountant General; June 2021) • Publish information on non-financial assets in the government's annual financial statements (Accountant General; ongoing)	15	✓

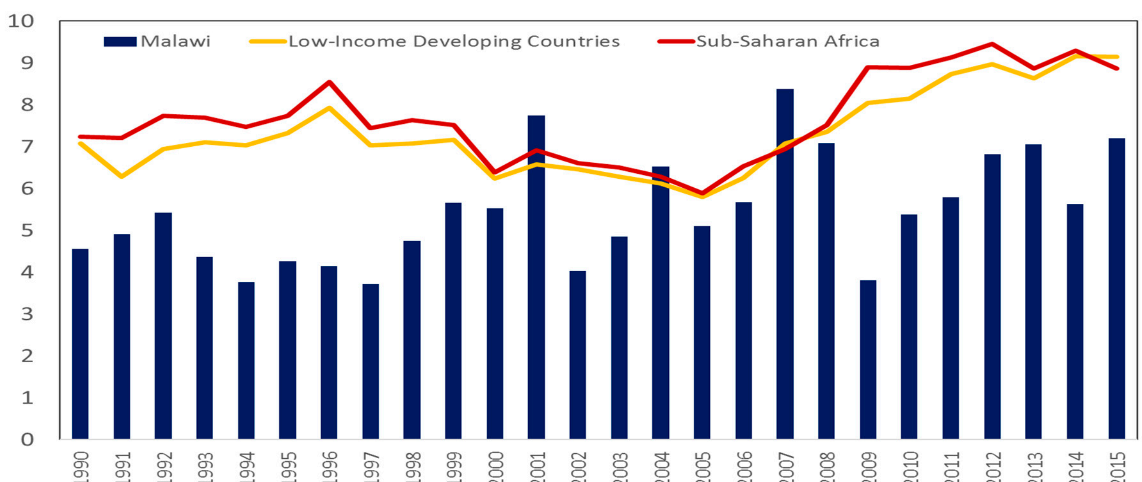
I. PUBLIC INVESTMENT IN MALAWI

A. Total Public Investment and Stock of Capital

1. Malawi has just started to recover from two years of drought. The recently completed Extended Credit Facility (ECF)-supported program helped in stabilizing the economy, but the inflationary impact of exchange rate depreciation, scandals involving misappropriation of public funds, the severe drought, and delayed implementation of structural reforms contributed to poor progress in achieving inclusive growth. The government places a high priority on stepping up infrastructure investment in priority sectors (especially roads, telecommunications, water and irrigation) and social spending (particularly education, healthcare, and gender). These objectives are enshrined in the third phase of Malawi's Growth and Development Strategy (MGDS III) which covers the period 2017-2022, and aims to build a productive, competitive, and resilient nation by spending an additional US$ 1.2 billion, over 19 percent of GDP, on capital projects during the next five years.

2. For almost three decades, Malawi's public investment as a share of GDP has been below the average of SSAs and other low-income countries (LICs). During the past 25 years, the level of public investment in Malawi has averaged about 5.5 percent of GDP, which is generally lower than in sub-Saharan Africa (SSA) and other low-income countries (averaging about 7-8 percent of GDP), but has picked up slightly in the last decade (Figure 1). The level of public investment has also fluctuated considerably from year to year, reaching 8.4 percent of GDP in 2007, before dropping to 3.8 percent of GDP in 2009, for example.

Figure 1. Public Investment
(Nominal, % GDP)



Sources: World Economic Outlook (WEO) and staff estimates based on official data

3. Malawi has a relatively large public capital stock (representing about 104 percent of GDP in 2015), but the stock per capita is low in comparison to peers. The growth in the nominal capital stock has been partly[1] made possible by relatively steady (primarily donor-funded) public investment over the last decade. For most of the last 25 years, the public capital stock was below the level in other SSA countries before catching up in 2010 (Figure 2). Nevertheless, Malawi's capital stock per capita remains among the lowest in the SSA region at USD 1.1 thousand (in 2011 PPP$-adjusted), half that of Zambia, and eight times lower than Namibia's, for example (Figure 3).

Figure 2. Public Capital Stock (Nominal, % GDP)

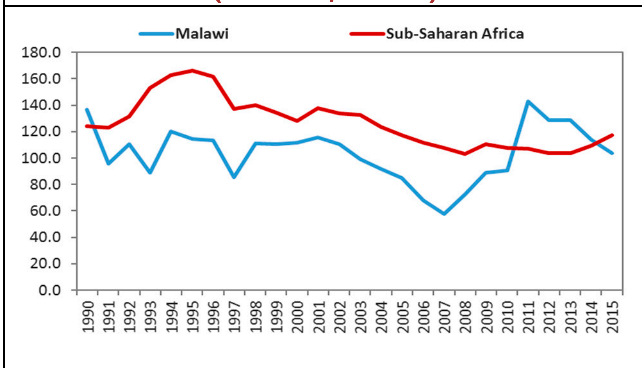
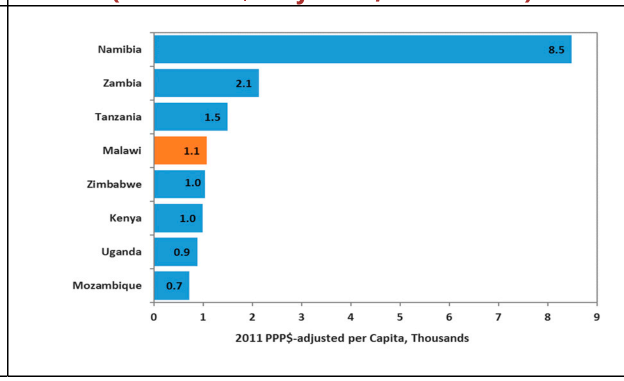


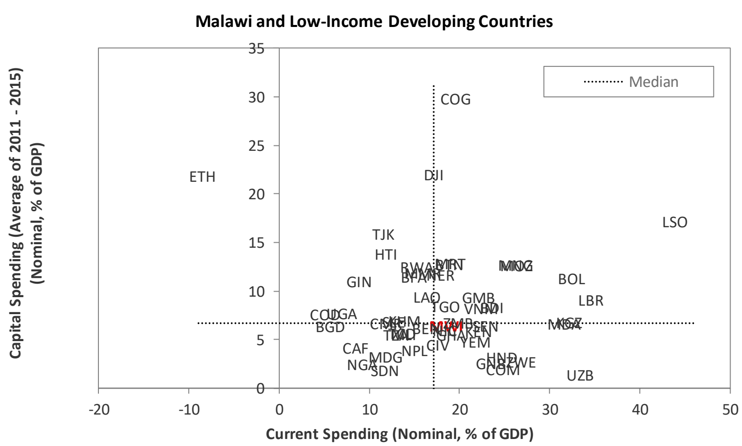
Figure 3. 2015 Public Capital Stock per Capita (2011 PPP$-Adjusted, Thousands)



Sources: World Economic Outlook (WEO) and staff estimates based on official data.

4. To the detriment of capital spending, the last few years have seen a steady rise in recurrent spending by the government—much of it on wages and salaries, together with higher interest payments on domestic debt—which reached more than 23 percent of GDP in 2015/16, and averaged 18.5 percent of GDP over the last five years (Figure 4).

Figure 4. Current Spending (Average of Last 5 Years) vs. Capital Spending (2015)



Sources: World Economic Outlook (WEO) and staff estimates based on official data.

[1] Other factors include the price level of the capital stock in Malawi which increased 65 percent from 2010 to 2011, implying that the price of capital goods spiked dramatically during that period.

5. Over the past 25 years, private investment has been generally higher than public investment, averaging 8.6 percent of GDP. For more than a decade between 1993 and 2004, total investment in Malawi—public and private—remained flat at about 11.6 percent of GDP, before picking up slightly in the next decade, averaging 15.7 percent of GDP, led mainly by private investment (Figure 5). Furthermore, for the last decade, GDP growth has followed a similar trend as the real capital stock, suggesting that more efficient public investment has had a positive impact on growth (Figure 6).

Figure 5. Public Investment and Private Investment (Nominal, % GDP)

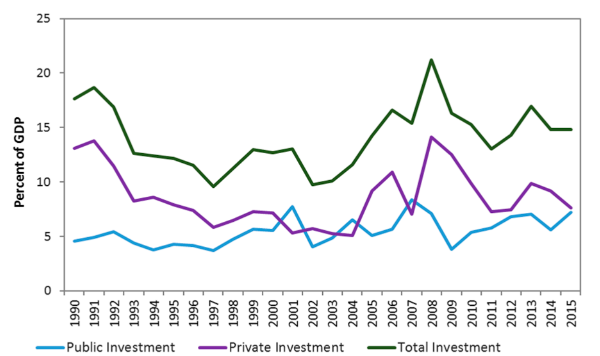
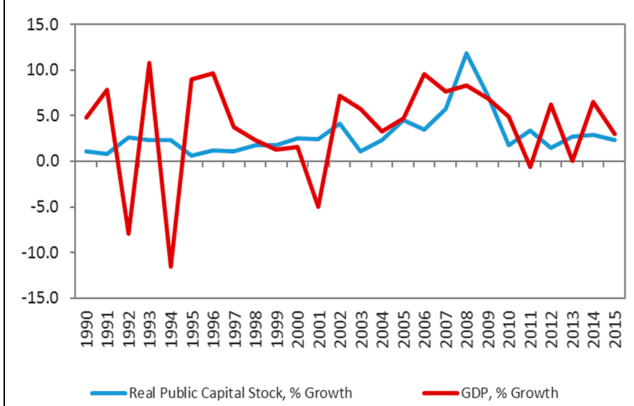


Figure 6. Public Capital Stock (Real, % GDP) and GDP Growth



Sources: World Economic Outlook (WEO) and staff estimates based on official data

B. Composition of Public Investment

6. Public investment in economic and social infrastructure accounts for about three-quarters of total investment in Malawi, which is broadly in line with the SSA average. About 54 percent of the central government's total public investment is allocated to economic infrastructure which comprises the transport sector (including roads), energy, communication, agriculture, and manufacturing, all critical for economic growth. In comparison, on average, SSA countries allocate about 45 percent of total public investment to economic infrastructure, which is about 10 percentage points less than Malawi (Figure 7). By contrast, Malawi directs only 21 percent of total public investment to the social sector, comprising education, health, and social welfare, which is significantly less than the average of 32 percent in SSA countries (Figure 8).

7. Public investment in Malawi is heavily dependent on external financing. Project loans and grants accounted for more than 84 percent of total public investment in 2017. This represents a significant increase from 2015 when only 64 percent of total public investment was externally-financed. (Figure 9). Over the last three years, project grants have averaged 54 percent of total externally-financed projects compared to 46 percent for project loans. (Figure 10).

Figure 7. Malawi Public Investment by Function (2011, Percent of Total Public Investment)

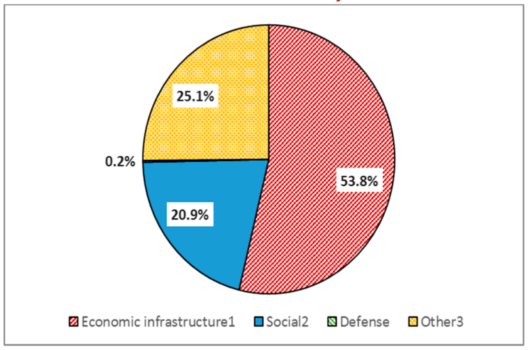
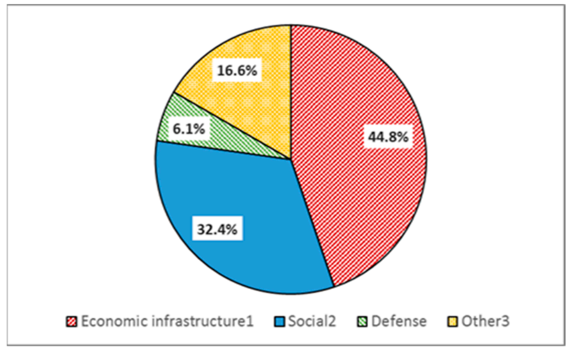


Figure 8. SSA Public Investment by Function (2011, Percent of Total Public Investment)



Sources: WEO and Staff Estimates based on official data.
1/ Economic infrastructure is approximated by economic affairs and includes public investment for transportation infrastructure, among other components.
2/ Social comprises public investment in education, health, housing, social protection, and recreation and culture.
3/ Other includes public investment for general public services, safety and public order, and environment.

Figure 9. Public Investment by Source of Financing (Percent of Total Public Investment)

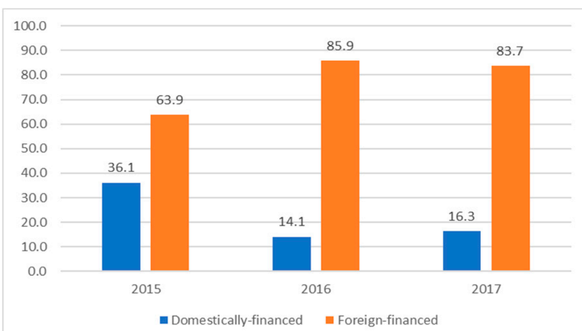
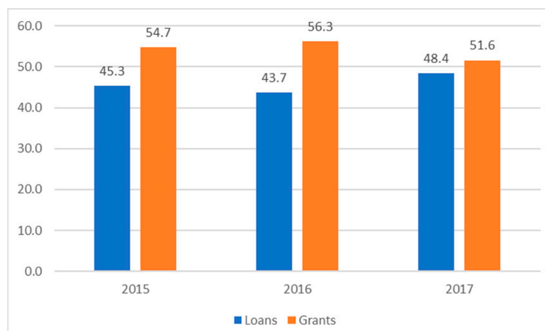


Figure 10. Loans vs. Grants (Percent of Total Externally-Financed Projects)

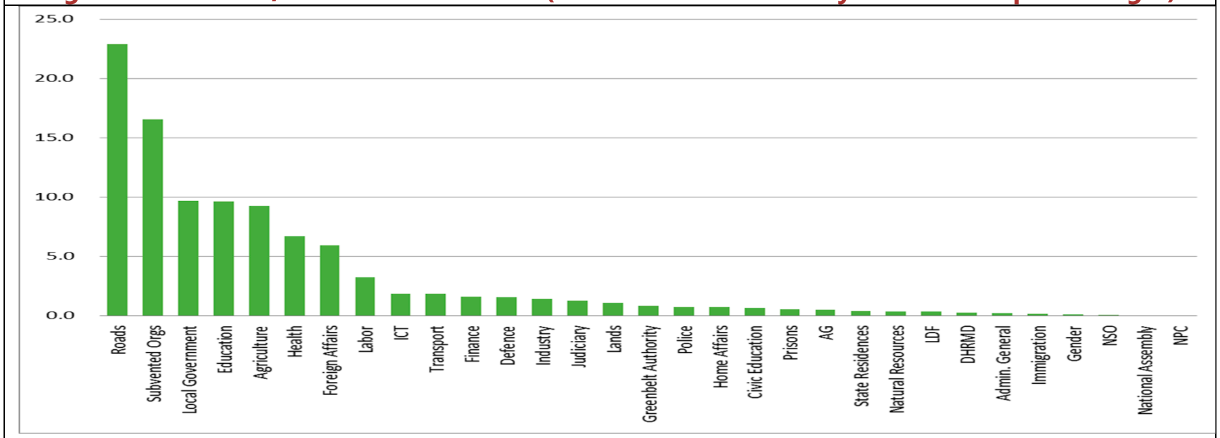


Source: MoFEPD, and Staff Estimates

8. **Domestically-financed capital budget is concentrated in two sectors.** The transport sector and organizations such as parastatals and some state enterprises that receive financing through the budget ("subvented organizations") account for about 40 percent of this spending. The social sector, including health and education, account for only about 17 percent of the total domestically-financed capital budget. (Figure 11).

9. **Public-private partnerships (PPPs) are currently insignificant in Malawi.** The country's PPP capital stock is less than 0.1 percent of GDP, much lower than the average for SSA countries (4.2 percent of GDP) or low-income countries (7.3 percent of GDP), as well as Malawi's peers in the region (Figures 12 and 13).

Figure 11. FY 2017/18 Sector Allocation (Percent of Domestically-Financed Capital Budget)



Source: MoFEPD

Figure 12. Public-Private Partnerships Capital Stock (Nominal, % of GDP)

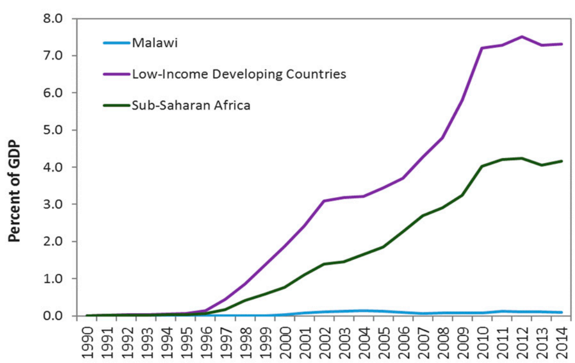
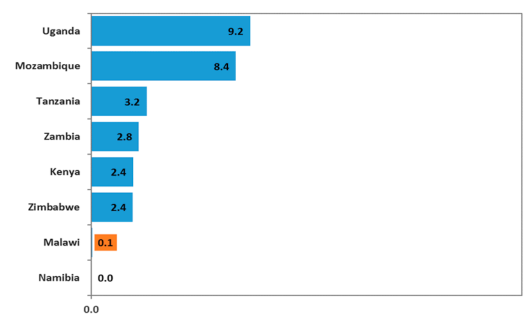


Figure 13. Public-Private Partnerships Capital Stock – Relative to Regional Comparators (Nominal, % of GDP)



Source data: WB/PPIAF data base and staff

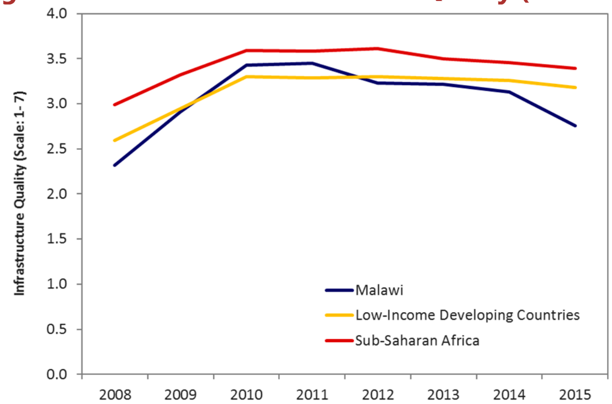
II. EFFICIENCY AND IMPACT OF PUBLIC INVESTMENT

A. Public Investment Impact

10. Infrastructure quality in Malawi is generally perceived as being lower than in SSA and other LICs, and has been declining since 2011. According to surveys conducted by the World Economic Forum,[2] on a 7-point scale, the overall score for the perceived quality of public infrastructure in Malawi was 2.75 in 2015, compared to 3.45 in 2011, levels which are slightly above the average of low-income countries, but still below the SSA average (Figure 14).

[2] The World Economic Forum surveys business leaders' impressions of the overall quality of key infrastructure services. While this indicator provides a measure of the overall quality of infrastructure assets, it is affected by individual perception biases.

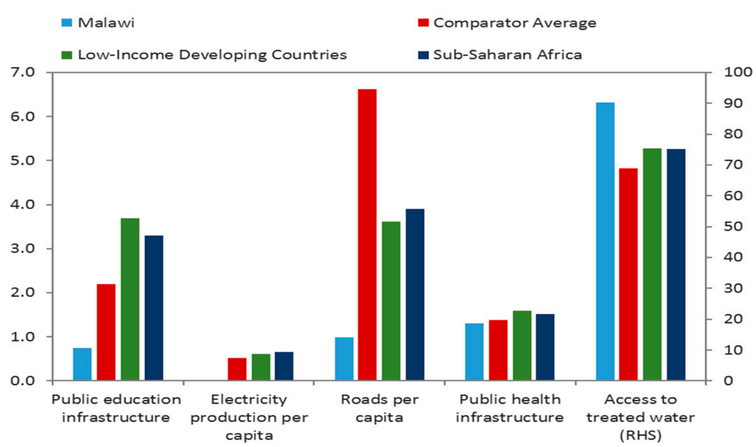
Figure 14. Perceived Infrastructure Quality (2006–15)



Source: World Economic Forum and Staff Estimates.

11. **Access to physical infrastructure in Malawi is worse than comparator countries with regards to investments in the education, roads, and health sectors, but better with regards to treated water.** Scores relating to education infrastructure and roads per capita are particularly poor (Figure 15). A recent IMF study shows that there is significant room to improve public expenditure efficiency in areas such as health and education.[3] The results of the study were mixed. It concluded that despite reduced health spending in Malawi, health outcomes have continued to improve (Figure 16). By contrast, however, although education spending has increased in recent years, reaching levels above the average for LICs, education performance has remained broadly unchanged (Figure 17).

Figure 15. Measures of Infrastructure Access and Service Delivery (most recent year)

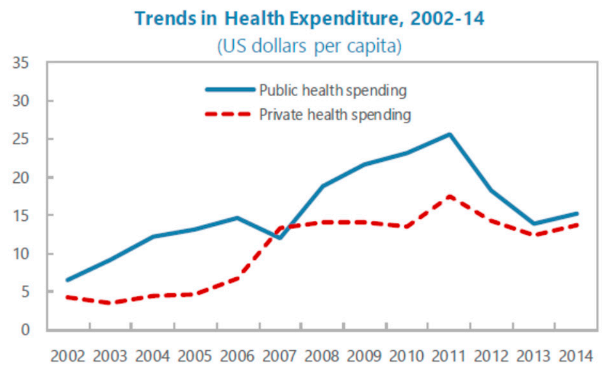


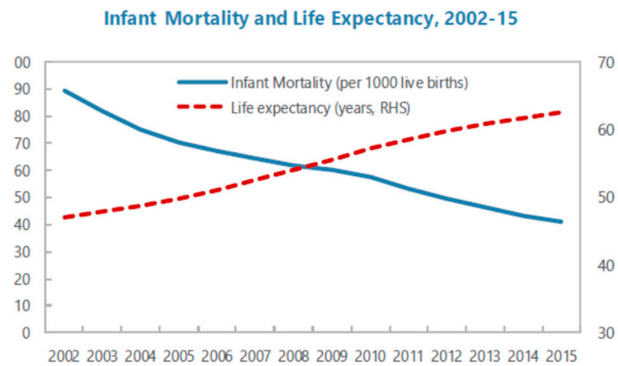
Source: World Bank and Staff Estimates.

* Public education infrastructure is measured as secondary teachers per 1,000 persons; Electricity production per capita as thousands of kWh per person; Roads per capita as km per 1,000 persons; and Public health nfrastructure as hospital beds per 1,000 persons. The most recent year is used for each indicator depending on the availability of data.

[3] See IMF, African Department, Selected Issues Paper (draft). April 2018. *Efficiency of Public Spending on Health and Education in Malawi.*

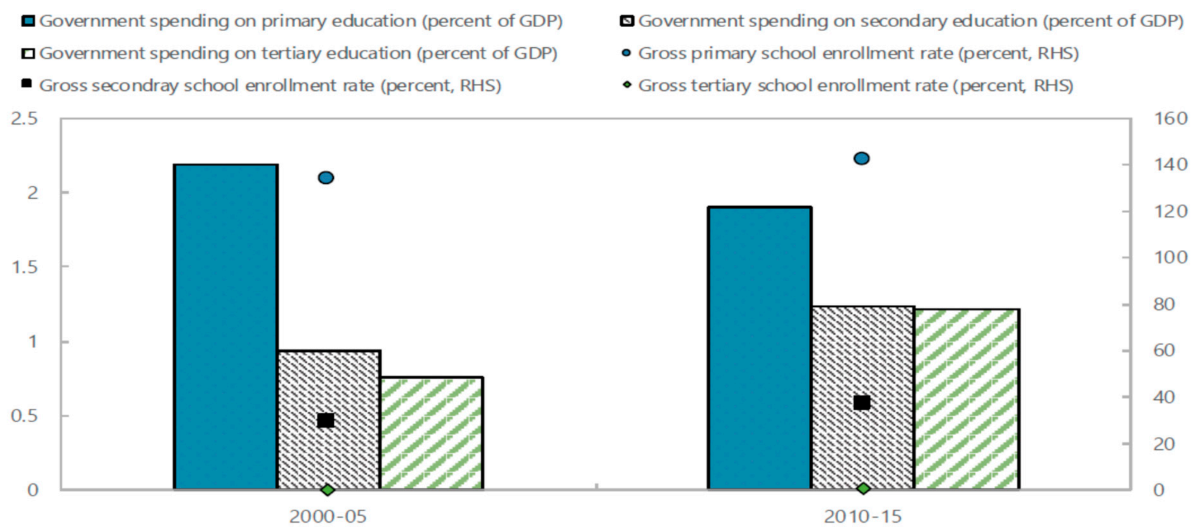
Figure 16. Health Spending and Outcomes





Sources: Country authorities, World Bank; IMF staff estimates.

Figure 17. Public Spending on Education and School Enrollment Rate, 2000–15



Sources: Country authorities, World Bank, and IMF staff estimates.

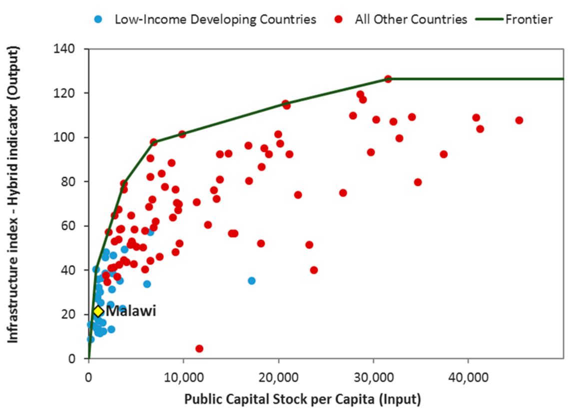
B. Public Investment Efficiency

12. The IMF's methodology for estimating the efficiency of public investment was set out in a policy paper Making Public Investment More Efficient published in 2015.[4] Simply stated, a country's performance on an index of the output of public investment is compared to its per capita public capital stock, or input. A "frontier" is drawn consisting of the countries achieving the highest output per unit of input. The IMF has prepared a database which enables the performance of each country to be compared relative to the frontier. To make the comparisons more meaningful, Malawi is compared with SSA countries, LICs, and all other countries (Figures 18 and 19). The estimated efficiency gap of 36 percent in Malawi is broadly comparable to SSA and LICs, but worse than the best performing countries. There is thus

[4] See http://www.imf.org/external/np/pp/eng/2015/061115.pdf

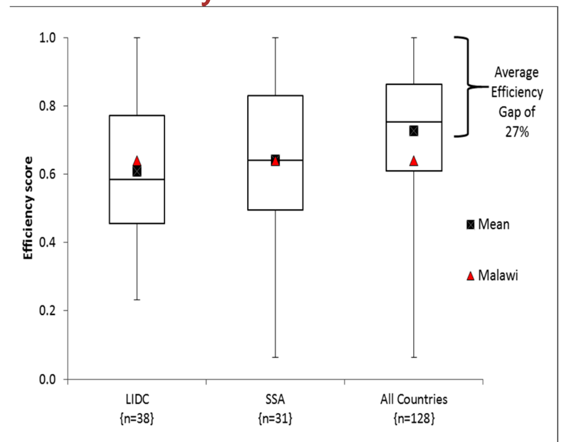
substantial scope for the Malawian authorities to adopt policies that will help improve the level of efficiency of public investment. Chapter III of this report analyzes where these gaps lie by assessing the strength of 15 PIM institutions across the planning, budgeting, and implementation cycle, and proposes recommendations to help close the efficiency gap.

Figure 18. Efficiency Frontier, Hybrid Indicator



Source: Staff Estimates

Figure 19. Efficiency Index, Hybrid Indicator

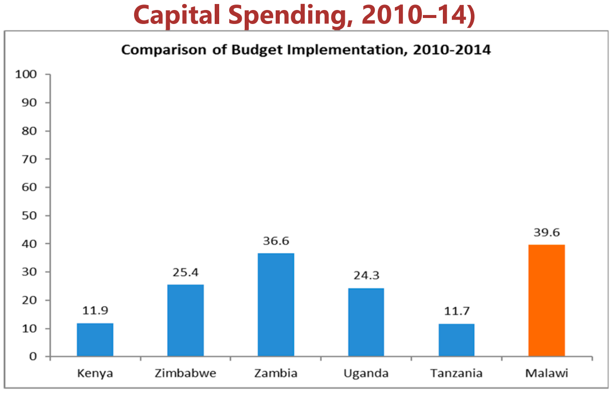


Source: Staff Estimates

C. Measures of Public Investment Performance

13. Malawi's performance on other measures of public investment is relatively poor. The gap between planned and executed capital spending is higher in Malawi than its neighbors (Figure 20). Excluding Zimbabwe, Malawi's public investment is also the most volatile in the region. (Figure 21).

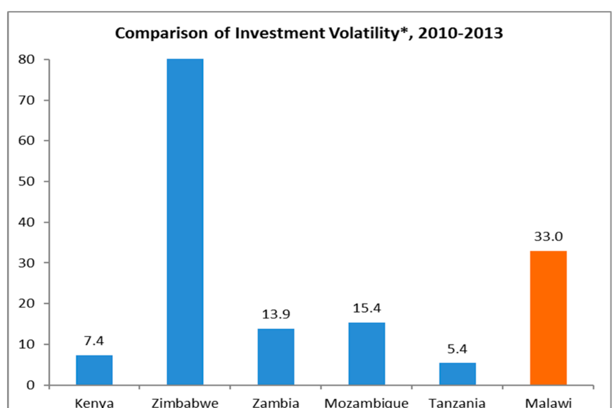
Figure 20. Execution of Capital Expenditure (Average Absolute Deviation from Planned[1] Capital Spending, 2010–14)



Source: Staff Estimates[1]

[1] This graph (and graph 15) is based on the IMF's WEO database, which may not reflect execution rates as calculated through the annual budget; however, it allows for cross-country comparisons.

Figure 21. Investment Volatility Average 2010–13)



*Volatility is calculated as the standard deviation of year-onyear growth of investment to GDP ratios (real, deflated, and ppp-adjusted).

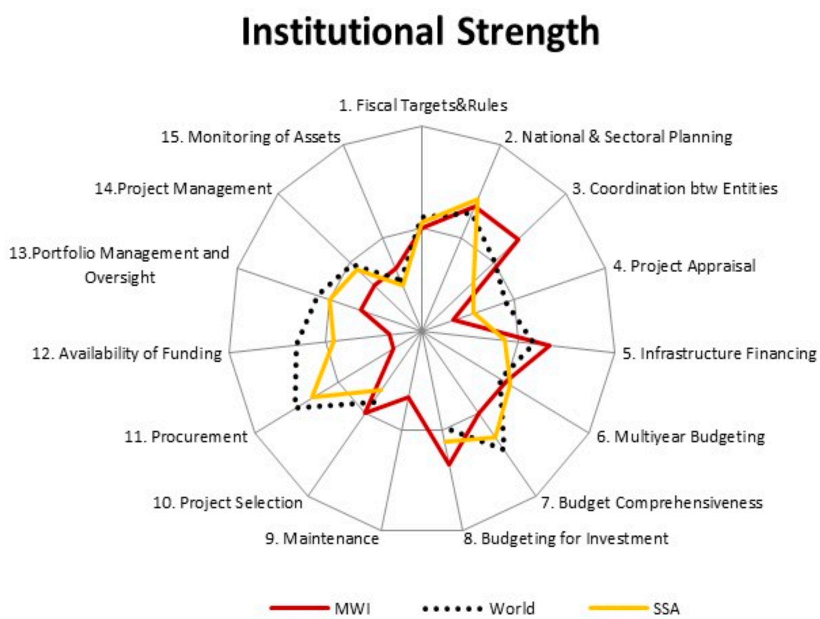
Source: Staff Estimates

III. PUBLIC INVESTMENT MANAGEMENT ASSESSMENT

A. Overall Assessment

14. The strength of Malawi's PIM institutions is generally comparable to SSA countries and other LIDCs (Figure 22). Malawi has stronger institutions than its comparators in the areas of coordination between entities, infrastructure financing, and budgeting for investment. Nevertheless, its PIM institutions are weaker in project appraisal, budget comprehensiveness, procurement, availability of funding, portfolio management and oversight, and project management.

Figure 22. Malawi's PIM Institutional Strength Relative to Comparators[1]



[1] Number of countries in SSA comparator is 13, while in World comparator is 29. There is no comparator data for Institution 9 "Maintenance Funding."

15. Despite the relative strength of Malawi's PIM institutions, many of them are not being implemented efficiently and effectively (Figure 23). The gap between PIM institutional strength and its effectiveness is quite pronounced in all areas except project selection, suggesting the need to focus on the better implementation and enforcement of the existing framework of laws, regulations, and procedures that support PIM.

16. Malawi has an opportunity to perform better than its comparators on key PIM institutions over the next five years. Building on the ongoing review of the Public Finance Management Act (PFMA), the country's overall PIMA rating could be considerably enhanced by implementing the recommendations put forward in this report. In particular, the projected institutional strength shown in Figure 24 below, could be achieved before 2022, provided the following key reforms—many of which are "low-hanging fruit", and could be introduced quite easily and quickly—are implemented.

- Strengthen the PFMA by incorporating provisions for a rule-based fiscal framework, requiring CBAs for major projects, and for reinforcing fiscal oversight of SOEs and other statutory bodies;
- Update the current procedures for costing the national and sectoral strategies within an approved resource envelope, as well as enhanced procedures for the budgeting of capital investment, such as early communication of budget ceilings to allow better prioritization of investment projects;
- Develop standard methodologies for project appraisal, estimation of maintenance costs, and project adjustment;
- Enhance the usefulness of the PSIP database by carrying out an audit aimed at improving its coverage, reporting functionality, links with the budget, and interfaces with other systems.

Figure 23. Malawi's PIM Effectiveness

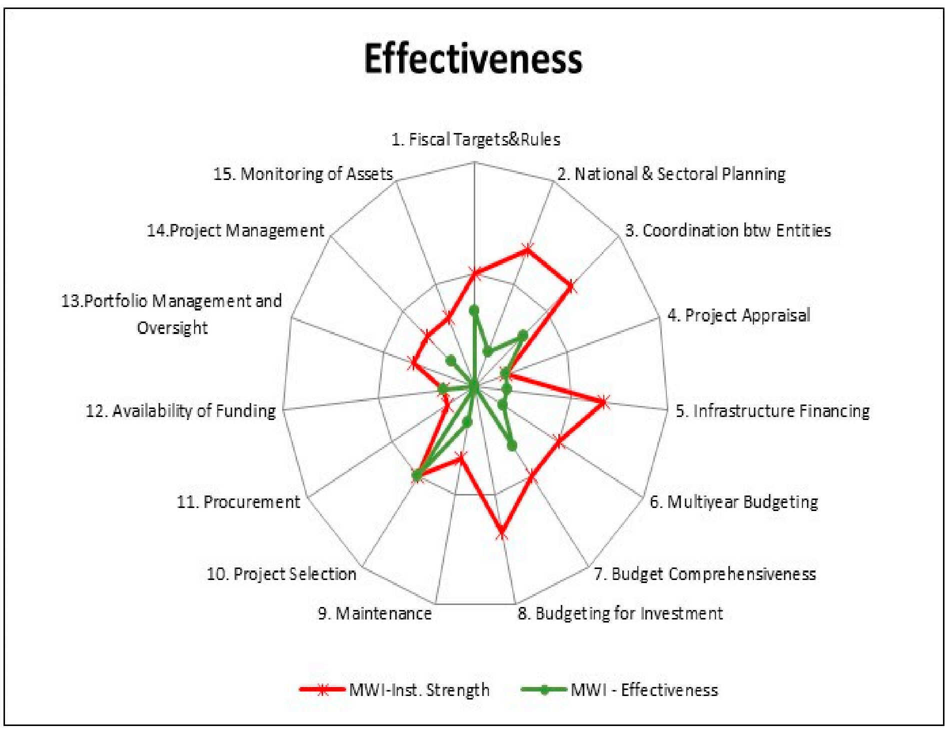
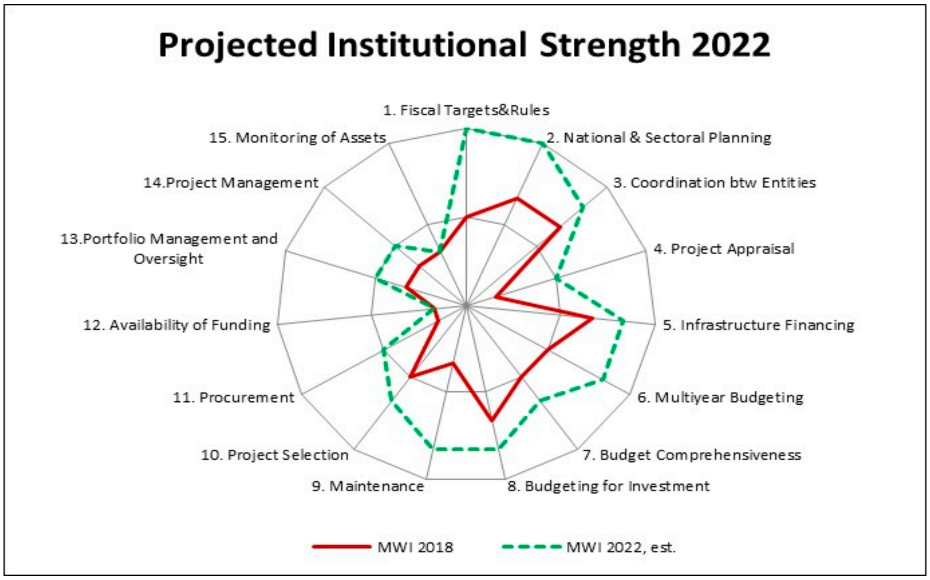


Figure 24. Malawi's Projected PIM Effectiveness



B. Planning Sustainable Levels of Public Investment

1. Fiscal Targets and Rules (*Institutional Strength – Medium; Effectiveness – Medium*)

17. Fiscal policy is guided by several principles set out in the PFMA, but these are too general to serve as an effective anchor for fiscal policy. The PFMA requires *inter alia,* that the government shall: i) manage public debt at prudent levels to provide buffers against factors that may impact adversely the total public debt; ii) ensure that total expenditures are consistent with a prudent level of borrowing and the attainment of fiscal sustainability; and iii) manage fiscal risks prudently. No numerical rule is provided in the legislation and regulations. The PFMA also requires that the MoFEPD presents its fiscal policies in the Economic and Fiscal Policy Statement (EFPS) to the legislature (National Assembly)[5] ahead of the budget. The multi-year fiscal aggregates (revenues, financing, recurrent expenditures, and development expenditures) are presented together with the budget in the government's Annual Economic Report (AER).[6]

18. There is a restriction on domestic debt, which serves as an anchor to fiscal policy in Malawi, but is not always complied with. According to the Treasury Instructions,[7] domestic Treasury-bill issuances are capped at 25 percent of total budgeted revenues for the current fiscal year. This restriction concerns only central government debt, and the limit does not apply to domestic debt issued through any other means (promissory notes, or ways and means advances

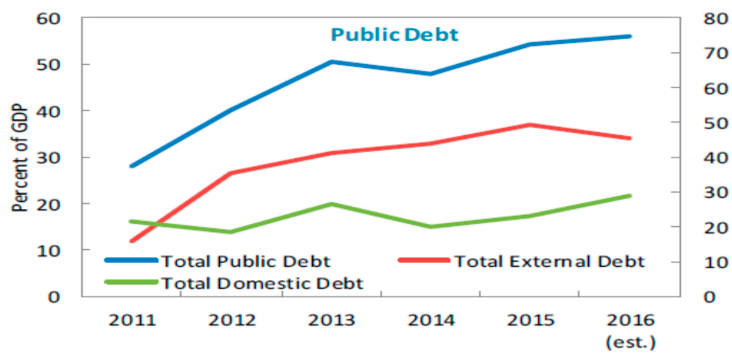
[5] Presented no later than April 1st each year.

[6] Presented to the National Assembly no later than June 30th each year.

[7] See Article 7.8.2

by the Reserve Bank of Malawi,[8] for example). The level of public debt is not limited in the medium-term, and since 2007, has more than doubled, from 26.7 percent of GDP after the debt relief granted to Malawi in 2007 to 54.3 percent of GDP in 2017 (Figure 25). The ratio now stands higher than the SSA average, which was close to 45 percent of GDP in 2016.

Figure 25. Evolution of Public Debt
(in percent of GDP)



Source: IMF report on the 9th review under the ECF arrangement, national authorities and staff estimates.

19. The EFPS contains no medium-term fiscal targets that would guide fiscal decision making or help take corrective measures, but fiscal policy is *de facto* constrained. While the Treasury-bill issuance target is guiding fiscal policy (see above), there are no multi-year projections on the debt limit, nor does the government provide any explanation of how this limit is used in making the projections of expenditure and revenue that are presented in the AER. While there is no published fiscal target supporting fiscal policy, the ECF arrangement includes performance criteria and indicative targets that serve as anchors to fiscal policy. Yet, the ECF is not embedded in law and is temporary by nature, underscoring the need to introduce a more permanent mechanism to ensure fiscal sustainability.

20. Revisions of the current fiscal principles and debt limit to better ensure fiscal sustainability are envisioned. The PFMA is under revision and options are being considered for a new debt rule, which could include: i) a cap on total net domestic debt, which has increased sharply given the decline in external financing, following the Cashgate scandal; and ii) a limit on the central bank financing of government debt, which was largely used to finance the deficit. The last ECF review underscored the need to anchor the fiscal policy on a primary fiscal balance and a debt-to-GDP ratio target below 50 percent.[9] A revised PFMA could include this fiscal target and

[8] This restriction does not currently apply in practice, since the government converts outstanding ways and means advances into T-bills whenever the ways and means limit is reached.

[9] The successor program provides that fiscal policy will be anchored on gradual movements in the primary balance while safeguarding social spending, with the aim of reducing public debt from 55 percent of GDP in 2018 to 45 percent over the medium term.

rule and, more broadly, fiscal responsibility provisions, that would strengthen the macro-fiscal framework and fiscal discipline, including in regard to public investment (see Box 1).

Box 1. Fiscal Responsibility Laws (FRLs)

Fiscal responsibility laws are permanent institutional arrangements to promote fiscal discipline, increasingly gaining support in Latin America, Europe, and Asia but also in East Africa (e.g., Kenya and Uganda's Charter for Fiscal Responsibility). FRLs may include procedural and numerical rules, or both.

The *procedural rules* aim to enhance transparency, accountability, and fiscal management by generally requiring the government to commit to a monitorable fiscal policy strategy, usually for a multiyear period, and to report and publish fiscal outcomes and strategy changes on a routine basis (e.g., Chile and Peru). The FRL could require, for example, that the annual budget be formulated in accordance with a well-structured medium-term fiscal framework (MTFF) and that the MTFF provides macro-fiscal forecasts for the following three fiscal years, incorporating the fiscal measures to achieve the fiscal target. Spending plans set out in the budget, including those related to investment, would need to be set in accordance with the resource envelope identified in the MTFF.

Numerical fiscal rules in FRLs are also common, and are intended to establish a permanent constraint on fiscal policy, generally in terms of an indicator of fiscal performance. The choice of a numerical fiscal rules would require a deep analysis of the drivers of fiscal policy and the economy and are usually based on several criteria:

• Sustainability: Compliance with the rule should ensure long-term debt sustainability.
• Stabilization: Requires that the rule helps reduce economic volatility by letting automatic stabilizers operate and/or allowing discretionary countercyclical changes in taxes or expenditures.
• Simplicity: The rule should be easily understood by decision makers and the public.
• Operational guidance: It should be possible to translate the rule into clear guidance in the annual budget process.
• Resilience: A rule should be in place for a sustained period to build credibility, and should not be easily abandoned following economic of financial shocks.
• Ease of monitoring and enforcement: Compliance with the rule should be easy to verify.

FRLs also include mechanisms that maximize reputational cost, such as establishing the obligation to explain deviations from the fiscal targets to the legislature and to publish such explanations in the finance ministry's external website. FRLs also specify when and how to correct deviations from the rule to deal with exceptional events outside the government's control (such as natural disasters and sharp economic shocks), and should include well-defined escape clauses from the requirement to meet fiscal targets. These clauses set the conditions under which a fiscal objective can be suspended in the event of an exceptional and unforeseeable shock. In Kenya, for example, the 2012 PFM Act provides that the government can deviate from their financial objectives where such deviation is necessitated by a major natural disaster, a significant unforeseen event, or a change in government. Such deviations should be explained in a budget policy statement by the government to the parliament.

Finally, FRLs generally include provisions for accountability and transparency. For example, they may specify the data to be included in fiscal reports, including on public investment, and the frequency and timing of such reports.

Source: FAD

2. National and Sectoral Planning (*Institutional Strength – Medium; Effectiveness – Low*)

21. The MoFEPD provides overall strategic guidance on national development planning under the Malawi Vision 2020 Strategic Plan.[10] The National Planning Commission (NPC) has been legally constituted with a mandate to ensure that all MDAs align their sectoral plans, activities, and budgets. The Commission is still in the process of being formally established as an operational entity. Nonetheless, the strategic planning process is well-structured into series of medium-term national development plans (MGDS), which includes broad estimates of the costs of these plans, covering five years.[11] The sector strategies that underpin the MGDS cover all the major economic, social and strategic sectors, and identify objectives, milestones, activities, outputs and outcome targets. Despite this well-structured process, there are significant capacity constraints that adversely affect the execution of the planning process at MDA level. [12]

22. Sector Working Groups (SWGs) develop medium-term investment plans and annual work-plans that are integrated into the national planning, budgeting and monitoring system through the Public Sector Investment Program (PSIP) process.[13] These groups include representatives of the relevant MDAs, SOEs, and extra-budgetary entities. The SWGs consult with relevant stakeholders, which includes a review of sub-national plans that reflect local development priorities, to formulate refined five-year investment plans. The priorities reflected in the sector plans are distilled into annual work plans, which lie at the heart of the PSIP process (see Figure 26). Although these plans contain various indicators, the quality of targets and indicators in sector strategies are not always Specific, Measurable, Achievable, Realistic and Timely (SMART). Despite the comprehensiveness of the planning system, not all capital projects can be found in the budget because some development partners continue to fund capital projects outside the PSIP process.[14]

23. The MGDS contains data on the aggregate costs of flagship projects and most sector strategies include detailed costs of major investments. While information on costs is

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[10] Vision 2020—National Long-Term Development Perspective for Malawi is the full title of this document, which was prepared by the National Economic Council in 2000. A new document Vision 2050, which will replace the current Vision 2020 is being developed.

[11] The third of these plans, the MGDS III, covering the period 2017-2022, was completed in November 2017.

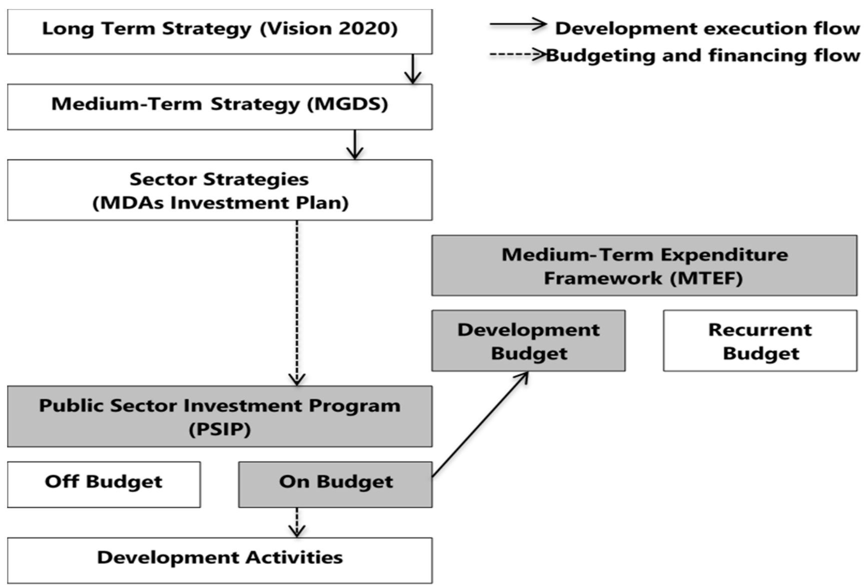
[12] The MoFEPD reported that, despite the deployment of economists to each of the central ministries under a common service mechanism, critical capacity gaps remain, notably in terms of cost-benefit analysis and project appraisal.

[13] The PSIP is a five-year rolling plan that provides details of the government's new, ongoing and proposed development projects, with estimated financial resource requirements for each project. It is reviewed annually and as such, informs the elaboration of the development budget.

[14] For example, the Bwanje Dam project funded by the EU and the SATTTFP (transport) project funded by the World Bank. Other projects not included in the PSIP are the MESIP (education) project funded by the GPE, and the Northern Region Health Facilities project funded by KfW.

provided in both the MGDS and sector plans, they bear little resemblance to Malawi's fiscal constraints or the overall budget envelope available for development projects. Sector strategies and sub-national plans are typically broadly defined, overly ambitious, and aspirational in nature, with actual investment ultimately being defined by the availability of resources and prevailing political priorities. The PSIP process can introduce new projects that significantly affect sector investment priorities. To address this challenge, sector strategies need to provide comprehensive descriptions of priority projects, with indicative estimates of life-cycle costs, and their annual breakdown, as well as expected outputs and outcomes.

Figure 26. Relationship Between MGDS, PSIP and Development Budget



Source: MoFEPD-PSIP Preparation Handbook

3. Coordination Between Entities (*Institutional Strength – Medium; Effectiveness – Medium*)

24. The Local Government Finance Committee (LGFC) has not succeeded in mobilizing funds for capital projects at the local level. The legal basis for the LGFC can be found in Article 149 of the Constitution, which mandates the LGFC to manage inter-governmental fiscal transfers between central and local tiers of government. The Local Government Act (1998) requires that 5 percent of general government discretionary spending should be directed through local councils but in practice the allocation has been much lower—on average, about 1–2 percent of their budget in 2016/17. These limited resources are used mainly to finance recurrent expenditure.

25. Transfers to local governments for capital projects are delivered through the Local Development Fund (LDF) mechanism, which is transparent and rule-based.[15] Funding for the LDF represents about 10 percent of total development spending in 2016/17. The LDF was originally established through a World Bank project to address the gap in capital investment at the local level. The Fund is a centrally administered mechanism that adopts a transparent process for allocating funds to local government, based on a formula with population and poverty being the main criteria.[16] Smaller scale community projects (less than US$100,000) are devolved for implementation directly by district assemblies whereas larger urban projects (greater than US$200,000) are centrally managed by the LDF secretariat. Consequently, despite their semi-autonomous status, local governments remain dependent on the LDF for capital investment linked to the implementation of local plans.

26. Institutional arrangements for managing fiscal transfers, including those to support capital projects, from central to local government, are in a state of transition. The LGFC and LDF were recently consolidated into a single operational entity that will evolve into a National Local Government Finance Commission. This new entity will have two main functions, the first on infrastructure development, with a priority to implement the integrated rural development strategy, and the second on financial management. During the transition phase to these new arrangements, there is some uncertainty about the coordination of fiscal transfers from the national to the local level.

27. Borrowing without the approval of the MoFEPD is prohibited for local governments by the Local Government Act (LGA, 1998) and for SOEs and statutory bodies by the PFMA. Section 48 of the LGA (1998) allows local governments, subject to the Finance and Audit Act, to raise loans within Malawi, but only with the endorsement of the Ministry of Local Government and Rural Development and approval from the MoFEPD. Section 48 allows local governments to obtain a bank overdraft subject to defined conditions. Sections 72–74 of the PFMA (2003) prohibits statutory bodies from borrowing, raising overdrafts and extending guarantees unless approved by the MoFPED. Sections 57–59 of the Public Private Partnerships Act (PPA, 2011) allow the Public Private Partnership Commission (PPPC) to raise funds for PPP arrangements, subject to the conditions of the PFMA, and the PPPC is obliged to disclose any post-transaction costs, including contingent liabilities, arising from a PPP transaction.

4. Project Appraisal (Institutional Strength – Low; Effectiveness – Low)

28. Major projects are not systematically subject to rigorous technical, economic and financial analysis, and there is no legal requirement for MDAs to conduct such analysis. The

[15] The LDF mechanism operates through four windows: community development, local government, urban development and capacity building, In the 2016/17 financial year it disbursed MK 36 billion (US$ 50 million) of which 95 per cent of funding was provided by development partners.

[16] The formula for intergovernmental fiscal transfers includes criteria such as the incidence of poverty, population, health indicators, and others.

PSIP Unit has issued guidelines on the management and appraisal of both new and ongoing projects. These guidelines have been designed both for PSIP focal points in MDAs and the PSIP Unit in the MoFEPD. Major projects are defined as those costing not less than US$ 100 million, and such projects require a pre-feasibility study to be carried out before the Cabinet Committee on Projects can consider them for approval. However, in practice, proposals for major projects are often submitted without a pre-feasibility study being undertaken. To address this concern, the PSIP Unit has submitted proposals for the PFMA (2003) to be amended to make it mandatory for feasibility studies to be conducted for major projects. During this review of the legislation, the threshold for major projects (which is high by international standards) could be reconsidered, and possibly lowered.

29. The PSIP guidelines focus on process management issues and do not provide sufficient guidance on, or support for project preparation. The PSIP Unit guidelines detail the steps in the PSIP process but do not provide detailed instructions on project preparation nor central support for MDAs on project appraisal. As a result, most government-financed projects undergo only limited scrutiny before being submitted to the PSIP Unit, and project appraisals tend to focus on costs rather than benefits of the project. In the absence of a centralized support mechanism, there is no effective independent review of projects submitted by MDAs. Consequently, key bottlenecks to project implementation related to inadequate analysis of risks, such as the availability of land for development and compensation for resettlement[17], sometimes emerge, and can result in significant delays. Such outcomes are more likely with government-funded projects because of the lack of technical skills and funding for proper project preparation.

30. Major projects financed by development partners typically require feasibility studies to be conducted as a prior condition of the loan or grant agreement. In addition, SOEs that undertake large capital projects, such as EGENCO, ESCOM, the Roads Authority and the Water Boards, always conduct feasibility studies as part of their project development cycle. Such studies are submitted to the corporation's board and implemented by management with oversight from the relevant ministry. However, some major projects escape this requirement. For example, it was reported in interviews that feasibility studies for two mega-projects involving some private sector participation, the Salima-Lilongwe Water Pipeline (approximately US$ 450 million) and the Kam'mwamba Coal-Fired Power Project (nearly US$ 600 million), have been conducted outside the responsible departments' framework. Little information on these projects has been made publicly available, and it is unclear where the value-for-money oversight function lies.

31. The PSIP process makes provision for a two-stage appraisal, but time constraints and capacity limitations render timely and objective evaluations of project viability difficult. In the PSIP guidelines, project appraisals need to be completed before the start of the

[17] In case of Ministry of Health, a land issue has delayed the implementation of the Domasi District Hospital project. Similarly, one of the concerns that resulted in the World Bank withdrawing support for the Lilongwe Water Supply Project was compensation for resettlement in Diamphwe.

budget preparation process. The first phase of the appraisal process enables MDAs to complete pre-feasibility studies, and the second-phase comprises an independent review by the PSIP Unit, based on the standard OECD criteria of the relevance, effectiveness, efficiency, impact, and sustainability of the proposed project. Once approved, the projects enter the 'project pipeline' for funding in the budget. In practice, MDAs are not able to undertake pre-feasibility studies due to a lack of funding and skills and, in the absence of such studies, the information from MDAs cannot be objectively evaluated. To address this challenge, a centrally managed Infrastructure Project Development Fund (IPDF) could be established from which MDAs could draw resources to improve the quality of feasibility studies and build capacity in MDAs and the PPPC (Box 2). Alternatively, to avoid the risk of possible misuse of resources provided though an extrabudgetary fund, financing could be provided directly through the budget to MDAs and the PPPC, earmarked for capacity development and feasibility studies.

Box 2. Proposed Infrastructure Project Development Fund

The government could establish an Infrastructure Project Development Fund to support project development through the PISP and PPP frameworks. The fund would support the financing of project preparation activities (engineering, economic, financial, public awareness, social and environmental and related studies) and, if necessary, the financing of consultants to undertake the required studies and the preparation of project implementation plans prior to the signing of the contract with the investor. The international development partners could assist in the initial financing of this fund.

The rationale for establishing a fund was initially proposed in the PPP Policy and Act (2011) to ensure that there were 'ring-fenced' resources to support lengthy and costly PPP transactions, and this requirement still stands. Following discussions with the PSIP unit in MoFEPD, it became clear that many public investment projects need to be subjected to rigorous cost-benefit analysis, but lack sufficient financial and human resources. It is possible that, in developing such a fund, two windows could be designed; one for traditionally-financed projects, the other for PPPs. The Fund could be centrally-managed, or provided as a budget allocation to MDAs to enhance project readiness, allowing unused allocations to lapse.

Source: Adapted from PPP Policy and Act (2011)

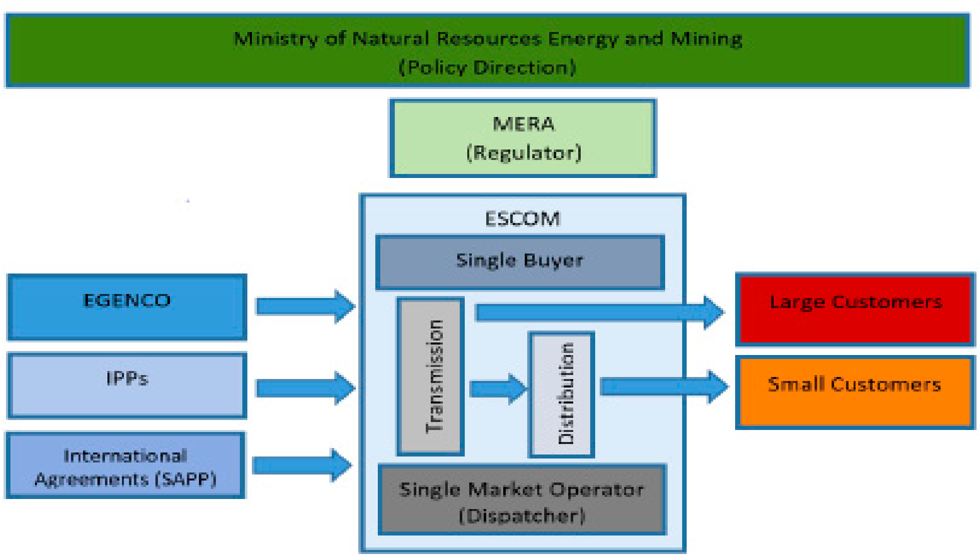
5. Alternative Infrastructure Financing (*Institutional Strength – Medium; Effectiveness – Medium*)

32. The legal and regulatory framework generally supports competition in markets for economic infrastructure, but the level of deregulation varies between sectors. The recent trend has been to open up infrastructure markets to more competition, and to attract additional private sector investment. The telecommunications and road transport markets are fully deregulated and liberalized. Water transport and rail services are provided through concessions with the private sector under long-term PPP contracts. Air transport services are partially privatized as the government retains a 51 percent stake in Malawian Airlines. The energy market now allows for the Independent Power Producers (IPPs), and water is provided by government-controlled water boards.

33. The legislation governing liberalized sectors provides a reasonably transparent and non-discriminatory environment that promotes competition in contestable infrastructure markets. The provision of economic infrastructure is not restricted to domestic monopolies in liberalized sectors, as there is free entry and competition in markets. Malawi only has two independent regulators in infrastructure, the Malawi Energy Regulatory Authority (MERA) and the Malawi Communications Regulatory Authority (MACRA). Regulation of transport markets is embedded within government with the parent ministry providing oversight for policy, standards, and compliance, and the MoFEPD taking responsibility for the enforcement of financial reporting standards. Regulation of the water sector is shared between the Water Resources Board (WRB), the Ministry of Irrigation, Agriculture and Water Development, and the MoFEPD.

34. Malawi has recently completed significant reforms to attract private sector investment into the energy sector but, despite some increases, tariffs have not yet reached cost-reflective levels. The Electricity Act (Amendment) 2016 liberalized the power market in Malawi. Under this law Malawi adopted a Single Buyer model of the power market structure (Figure 27). The Ministry of Natural Resources, Energy and Mining (MoNREM) is responsible for policy oversight, and the MERA for regulating the sector. The Single Buyer procures power from EGENCO, Independent Power Producers (IPPs), and the Southern African Power Pool (SAPP). ESCOM Transmission, under the supervision of ESCOM's Single Market Operator (SMO), acquires power from the Single Buyer and supplies it directly to large customers or to small customers through ESCOM Distribution. Interviews with both EGENCO and ESCOM confirmed that Malawi's energy sector is operating with a non-cost reflective power tariff. However, a cost-reflective tariff is key to enabling EGENCO and ESCOM to make appropriate power infrastructure investments, and for ESCOM to perform its role as a Single Buyer and SMO.

Figure 27. Malawi Power Market Structure



Source: EGENCO Integrated Strategic Plan (2018-2033)

35. The government through the MoNREM is spearheading efforts to move the prevailing market tariff towards a cost-reflective level. In November 2017, a 25 percent increase in electricity tariffs was approved, but a gap remains to put cost-reflective tariffs in place. Until such time, it will be difficult to attract significant private sector investment into the sector.

36. The PPP Act of 2011 guides the government's policy and engagement of PPPs and the divesture of SOEs. The PPP law provides for the separate evaluation, selection, and approval of PPP projects from other public investment projects. It also establishes the Public Private Partnership Commission (PPPC)[18] which is responsible for overseeing and coordinating policies, and for approving PPP projects and the divesture of SOEs.[19] The PPPC is supported by a dedicated Secretariat that provides advisory services to contracting agencies, checks the value-for-money and budget affordability of projects, and provides an opinion on proposed new PPP projects or divesture of SOEs, including associated fiscal risks.

37. Since its inception, the PPPC has made good progress, while market liberalization is creating a more conducive environment for the Commission to pursue larger and complex PPPs, particularly in the energy sector. Prior to 2011, the PPPC was mainly concerned with the divesture of SOEs. Since 2010, it has worked on and completed, or partially completed, six transactions involving PPP arrangements and three transactions involving the divesture of SOEs (Box 3). After detailed consultations with relevant MDAs, the PPPC has identified 24 candidate projects that should be assessed for their potential structuring as PPP transactions. These projects are in various stages of preparation. However, a key constraint identified by the PPPC would be to secure resources to undertake the required feasibility studies and other preparatory work. These resources could either be a window under the IPDF as described under Institution 4, or dedicated financing for PPP projects provided through a budget appropriation to the PPPC, as envisaged in the PPP policy framework.

38. The oversight function of SOEs is fragmented. The Public Enterprise Monitoring Unit (PERMU) in the MoFEPD is responsible for the financial oversight of SOEs, but has limited financial and human resources to undertake such work. The Department of Statutory Corporations in the Office of the President and Cabinet is responsible for the administrative oversight of SOEs and other statutory bodies. There are 67 statutory bodies, half of which operate on a commercial basis. The PERMU undertakes the review of the SOEs' investment plans of corporations and their financial performance. Currently, reporting by individual SOEs is infrequent and irregular. The overall performance of SOEs is not summarized into a consolidated

[18] The PPPC comprises a Chairman and four other members, who are appointed by the President. The Commission also has four ex-officio members who are the senior most officials from the MoFEPD, Ministry of Justice (MoJ) and Ministry of Industry and Trade (MoIT).

[19] The PPPC was originally established as the Privatization Commission in 2001, and this is why it has retained its privatization mandate, though transactions in this area have been limited in recent times.

report on their investment activities and financial performance. There are also no data on the financial support provided by the government in the form of subsidies, capital injections, on-lending and loan guarantees to these enterprises. Further, the oversight of SOEs in key infrastructure sectors is blurred by fragmented and overlapping roles between the MoFEPD, the parent line ministry, the Department of Statutory Corporations, and SOE boards, which is contrary to international good practice (Box 4).[20]

Box 3. PPP and Privatization Transactions

Privatization Transactions (2010-15)

- Malawi Savings Bank
- Indebank Limited
- Malawian Airlines

PPP Transactions (2010-15)

- Malawi Lake Services
- Central East African Railways
- Fiber Optic Link - Malawi, Tanzania and Zambia
- Liwonde National Park
- Nkotakota Wildlife Reserve
- Submarine Cable

Source: PPPC (2015)

PPP Pipeline Projects

- Liwonde and Nkotakota National Parks
- Golden Sands and Cape Maclear Eco-Lodges
- Fiber Optic Cable and Domestic Backbone
- Malawi Institute of Tourism
- University Accommodation (*4)
- Cultural Centre, Parkades, Public Sanitation (Blantyre)
- Bus Terminals (Blantyre, Lilongwe and Mzuzu)
- Produce Markets (Blantyre and Lilongwe)
- Solid Waste/Sewage Disposal (Blantyre, Lilongwe and Mzuzu)
- Shopping Mall and Amusement Centre (Mzuzu)
- Malawi Cargo Centre
- PVHES

Box 4. OECD Guidelines for SOE Governance-Key Recommendations

The government should develop an ownership policy to define the overall rationale for state ownership, the state's role in the governance of SOEs, and how the state will implement the policy. Key recommendations include:

- Define the rationale for owning individual SOEs and subject these to regular review.
- Public policy objectives of individual SOEs should be clearly mandated and disclosed.
- Costs related to public policy objectives should be funded by the state and disclosed.
- SOE boards have appropriate competencies and be allowed to exercise their mandate in an independent fashion.
- The government should exercise its ownership rights and focus on:
- Setting and monitoring the implementation of SOEs' policy mandate, including financial targets, capital structure objectives and risk tolerance levels; and,
- Setting up reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards.

There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for SOEs, notably regarding market regulation.

The exercise of ownership rights should be centralized in a single ownership entity or by a coordinating body, which should have the capacity and competencies to carry out its duties.

The ownership entity should develop consistent reporting on SOEs and publish annually an aggregate report on SOEs, including making use of electronic media options.

Source: OECD Guidelines on Corporate Governance of SOEs, OECD, 2015 (abridged)

[20] For guidance on the financial oversight of SOEs, see R. Allen and M. Alves, "How to Improve the Financial Oversight of Public Corporations," 2016, IMF.

Recommendations

Issue: National and sectoral strategies do not adequately guide public investment planning and budgeting. Many project appraisals do not include a cost-benefit analysis, or a full risk assessment and mitigation plan (e.g., on land acquisition or resettlement compensation).

Recommendation 1: Develop standard guidelines on project appraisal to support the PSIP process.

- Update the current PSIP manual with additional guidance on project appraisal (EP&D, December 2019)
- In coordination with the PSIP Unit, MDAs should update their sector strategies with information on the lifecycle costs, outputs and outcomes of priority projects (MDAs, December 2019)

Recommendation 2: Establish an Infrastructure Project Development Fund (IPDF), or comparable financing for MDAs and the PPPC through specific budget appropriations, to provide the resources needed to improve the quality of project appraisals, particularly for major capital projects, under both the PSIP and PPP framework.

- Develop operating procedures and practices for the IPDF (PSIP Unit and PPPC Secretariat, December 2018)

Issue: The PFM Act does not provide adequate legal basis to support the project appraisal and selection functions of the PSIP Unit within the MoFEPD.

Recommendation 3: Update the PFMA, specifically with respect to project appraisal and selection.

- Include a provision that mandates all capital projects be recorded in the PSIP database (EP&D, PFM Reform Coordination Unit, November 2018)
- Include a provision that mandates all major capital projects above a defined threshold (+/- S$ 100 million) to be subject to CBA (EP&D PFM Reform Coordination Unit, November 2018)

Issue: The existing institutional arrangements for oversight of the investment activities of SOEs is fragmented.

Recommendation 4: Improve the governance of statutory bodies by providing clearer roles and responsibilities for the financial oversight of SOEs' investment activities and financial performance.

- Include provisions in the revised PFMA to strengthen and clarify the financial oversight of SOEs, including the role of the PERMU, the President's Office, MDAs, and the boards of the SOEs (Public Enterprise Monitoring Unit, November 2018)

- Prepare a consolidated report of the investment activities and financial performance of SOEs, and associated fiscal risks (Public Enterprise Monitoring Unit, December 2019)

C. Ensuring Public Investment is Allocated to the Right Sectors and Projects

6. Multi-year Budgeting *(Institutional Strength – Medium; Effectiveness – Low)*

39. Malawi has made some progress in developing elements of a multi-year budget process. Medium-term projections of total expenditures, as well as revenue and financing, are included in the annual budget documents and other reports. The AER provides projections of the two following years for revenues, recurrent and development expenditures (by function) and financing. In the annual budget, projections of recurrent spending are made by MDAs, using an economic classification, for the upcoming fiscal year and two outer years. The projections of development expenditures are aligned with the approved projects included in the PSIP. The Malawian authorities have also engaged in the implementation of program-based budgeting, and expenditures are accordingly allocated by program, for three outer years[21]. The budget preparation process is guided by the instructions provided to the MDAs.

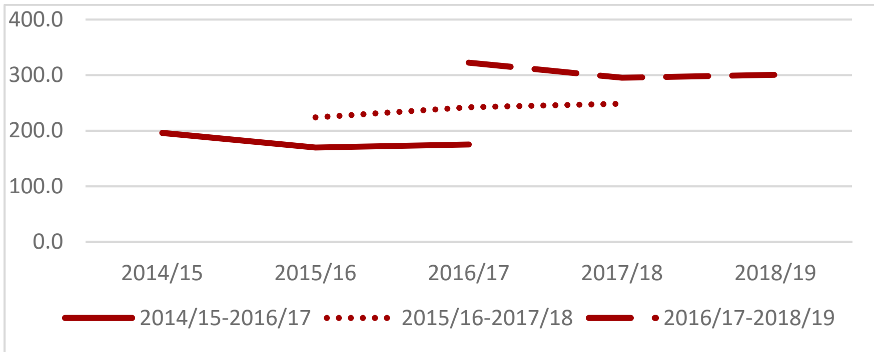
40. While the multiyear budgeting process is quite well-established, the core procedures are not in place for the MTEF to serve as a reliable anchor for planning investment projects over the medium term. Ceilings are provided late in the top-down/bottom-up process[22] and vary significantly over the budget process. Moreover, while the projections of development expenditures are included in the AER, the budget only provides the estimates for the budget year[23]. The ceilings of the MTEF in the AER are only indicative. As such, extensive revisions are made from one year to the next (Figure 28), partly because of the volatility of external financing. Moreover, while budget documentation is extensive, estimates of the total cost of projects are not published, nor the breakdown of these costs over the medium term. Finally, the budget documentation does not provide sufficient information on project priorities, including ongoing "flagship" projects identified in the MGDS III, which could help align the budget with the sector priorities.

[21] Budget Document number 5.

[22] MDAs confirmed to the mission that the final ceilings were received after the budget hearings in April. Indicative ceilings are provided by the MoFEPD in February/March and are reported to significantly vary from the final ceilings.

[23] Until the adoption of budget 2015/16, the projections for development expenditures were provided to MDAs, for both the budget year and the two outer years. This practice has been discontinued.

Figure 28. Variation of MTEF Projections on Development Expenditures *(in Billions of MK)*



Source: MoFEPD

41. The core mechanisms of multi-year budgeting need to be reinforced. In the current budget process, strategic budget hearings start in November, with the aim of identifying MDAs' priorities, but the delay noted above in providing spending ceilings to the MDAs leaves insufficient time for the strategic planning of domestically-financed projects. Moreover, the absence of multi-year projections of development expenditures by MDAs in the budget makes a full-cost comparison of projects financed through the budget impossible, and undermines realistic budgeting for their implementation. The availability of such information at an aggregate level, and by function, in the AER should serve as the basis for making multi-year projections in the budget. Strengthening the link between the PSIP and the MTEF is necessary to better identify the trends in capital spending, focus on strategically important projects, and provide information on their full cost that would facilitate reliable forecasts.

7. Budget Comprehensiveness and Unity *(Institutional Strength – Medium; Effectiveness – Medium)*

42. Malawi has implemented some good practices regarding budget comprehensiveness and unity. The recurrent and development budgets, including for externally-financed projects, are prepared by the MDAs and consolidated by the MoFEPD's Budget Department. Budget documentation also includes the development expenditures of statutory bodies[24] as well as information on recurrent and development budgets by ministry. A programmatic classification of the budget is also presented (Annex 7 and Document 5) but does not distinguish between development and recurrent expenditures. Finally, a large amount of

[24] Annex 7, code 275.

expenditure,[25] including development expenditures, is financed by NGOs and bilateral donors whose procedures are undertaken outside the budget.[26]

43. The clarity and transparency of the budget documentation could be improved for capital projects. Development expenditure as shown in the PSIP and the budget includes spending which is recurrent in nature, for example training and capacity development. This presents a distorted view of the level of capital investment and its composition.[27] An annex to the budget provides information on donor-financed capital projects, but these data are not broken down between capital and recurrent spending. Finally, information on the development budget for SOEs is not provided in the budget documentation.

44. Expanding budget information on SOEs and PPPs would enhance the transparency of investment activities of the government, and improve budget decision-making. Capital spending by SOEs is substantial, especially in the energy and water sectors, and is likely to grow. It is important that the authorities expand the published information on these investments and estimate any associated fiscal risks that could potentially impact the central government budget. Supplemental analyses of development spending and investment activities of SOEs would provide a better understanding of the impact of government activity on the economy. Likewise, budget documentation should be upgraded to include information on PPPs, which are expected to increase (see Institution 5), and which may impose potential fiscal risks.

8. Budgeting for Investment *(Institutional Strength – Medium; Effectiveness – Low)*

45. The PFMA and its regulations provide a reasonable amount of protection for capital investment through the budget. Section 25 of this Act specifies that transfers between line items are possible within an MDA, with the approval of the MoFEPD, provided that the transfers do not increase the line item appropriation by more than 20 percent. The Treasury instructions, article 4.16.5, stipulate that "*virement on the Development Account*[28] *shall apply only to the re-allocation of funds between program/items within the same vote, and every Controlling Officer shall obtain prior approval from the Secretary to the Treasury for a virement*", thus preventing any reallocations from the development budget to recurrent expenditures. Mid-year reviews are carried out each year and are subject to approval of the National Assembly. In principle, changes

[25] For 2016/17 budget, over 10 percent of total expenditures were realized off-budget. The budget documentation does not provide the segregation between current and development expenditures.

[26] Annex 11 of the budget documentation records the amount of these "off-budget" expenditures and their beneficiaries.

[27] Projects are considered as capital projects when 75 percent or more of the total costs is capital in nature.

[28] The development account, or development fund, is the accounting mechanism through which capital development appropriations are accounted for (see Treasury Instructions, chapter 4.16).

in capital expenditures are only possible when financing resources decrease or increase.[29] The government gives priority to the completion of ongoing projects, a requirement that is clearly stated in guidelines issued by the Budget Department ahead of the budget process.[30]

46. In practice, the efficient budgeting of capital projects faces some challenges:

- While the PSIP database provides the costs of projects for the whole duration of the project, this information is not referred to in the budget documentation, thus impairing the multi-year budgeting process and creating significant risks for arrears accumulation.[31]

- The practice of including multi-year commitments in the budget documentation was abandoned in 2015/16.

- The prioritization of ongoing projects is not systematic, especially if there are insufficient funds, or when priority is given to strategically-important new projects, selected at the expense of ongoing projects, often without a proper cost-benefit analysis.[32] For example, an analysis of the PSIP shows that some ongoing projects are not appropriated[33] in the budget even when they had not been suspended or terminated. Suspended ongoing projects are numerous, most of the time because of large cost overruns, thus increasing the risk of arrears accumulation. Similarly, some projects are included in the budget without being part of the PSIP (see Institution 2).

- Virements are not permitted between recurrent and development expenditures but there is no report available on the level of transfers, making it difficult to assess the compliance of the budget practices with the regulations.

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[29] As per the documentation received for several years, development spending is only reduced when resources decrease, especially external financing, which has been extremely volatile after the Cashgate scandal.

[30] The Budget Guidelines for 2017/2018, section 3.6.1, state that: "The backlog of current projects is to be cleared before new projects are contracted".

[31] Project 1236 in the database is an example. The Green Belt Initiative project, which started in 2012/2013, aims at constructing 530 hectares of irrigation schemes, and establishing nurseries. The total costs of the project recorded in the PSIP is MK 14.2 billion. In 2014/2015, project implementation was reported to have slowed down due to financial constraints. Out of the approved budget of MK 2 billion in 2014/2015, only MK 432 million was disbursed. According to the PSIP, the project had outstanding arrears with the contractor amounting to over MK 1.2 billion in 2014/2015. Over MK 300 million from the amount disbursed was used to pay arrears.

[32] Example of project 1808 (construction of new Mzuzu Airport), appropriated for MK 200M in the 2016/17 budget, without any cost-benefit analysis realized.

[33] Example of project 1319 (construction of the Treasury Cashier): while it is approved in the 2016/17 PSIP, it is not appropriated in the FY2016/17 budget. Example of project 1236 again, which shows as ongoing, has significant outstanding costs (12.6 billion MK out of 14.2 end of year 2015/16), and which is not appropriated for the budget 2016/17.

- A combination of overoptimistic budget, and weaknesses in cash flow forecasting (see Institution 12), leads to under-execution of capital expenditure (Figure 20).

9. Maintenance Funding *(Institutional Strength – Medium; Effectiveness – Low)*

47. Maintenance expenditure can be identified in the budget but cannot be easily tracked because of inconsistencies in the fiscal reports. The chart of accounts and the budget documents identify both routine and capital maintenance, consistent with international good practice. However, the level of aggregation used in the budget presentation does not allow for distinct reporting of these categories. In addition, there are discrepancies in the information presented in the annual financial statements that do not allow for easy comparison of maintenance expenditures. These discrepancies are related to the integrity and coverage issues in the current integrated financial management information system (IFMIS).[34] As a result, budget tracking of maintenance expenditure becomes difficult.

48. The absence of standard guidelines on budgeting for maintenance funding weakens the institutional framework. The Budget Manual (2009) does not provide any guidance on maintenance funding. The Budget Guidelines that are issued annually only require that future maintenance costs of completed development projects be established and included in the budget for subsequent years. These guidelines, however, do not provide guidance to MDAs on the establishment of maintenance schedules, assessing maintenance requirements over the life cycle of projects, entering into medium-term maintenance contracts, or making appropriate allocations for these purposes. There is no standardized methodology, including maintenance guidelines and minimum standards, issued by the government or by individual MDAs for estimating routine or capital maintenance requirements and their cost.

49. Across sectors, project owners invest too little in maintenance, creating potential for accumulating significant repair or rebuild costs in the future. Low levels of maintenance investment are driven by budget constraints, limited maintenance planning, and lack of incentives for project owners to focus on the preservation of existing infrastructure. Systematic information on the maintenance needs of MDAs is not available. Routine maintenance costs thus get budgeted on an incremental basis and within the constraint of pressures from more immediate needs. Though there are established procedures for the maintenance of government buildings that involve consultation and surveys conducted by the Department of Buildings, there is no standardized methodology for estimating these costs that can then be included in the budget submissions.[35] These consultations invariably take place after the budget has been approved and are subject to the availability of funds instead of being based on actual needs, often resulting in a reduction in quality or postponement of the maintenance activity. Major

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[34] The issues related to the current IFMIS have been discussed in greater detail in a recent FAD report *Malawi: Strengthening Financial Controls*, M. Alves et.al. April 2018.

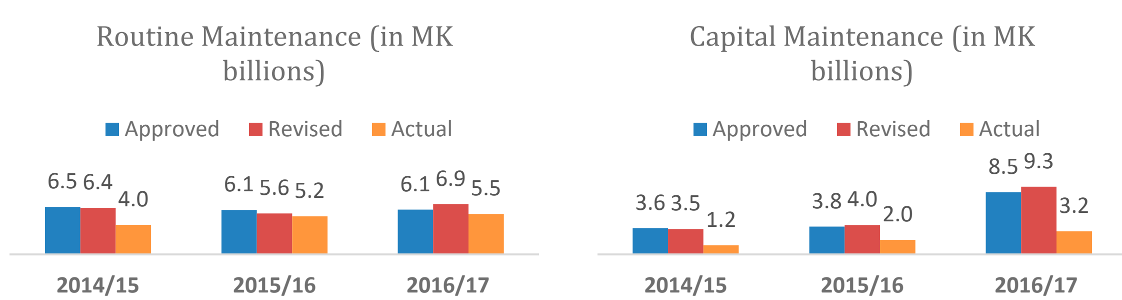
[35] A maintenance unit that is being planned in the Department of Buildings as part of this department's proposed functional review could be mandated to address these gaps.

building rehabilitation works that are undertaken as capital projects are, however, undertaken in a more planned and systematic manner, but remain vulnerable to funding constraints.

50. Some sectors, notably roads, have developed a standard methodology for determining the capital maintenance requirements that are included in their sectoral plans. The Roads Authority has issued guidelines on the estimation of costs related to road maintenance works. In addition, the Roads Fund Administration Act, 2006, created a fund, financed by a levy on petroleum fuels, that provides resources for the routine and periodic maintenance of public roads. These resources are ring-fenced, and are managed by the Road Fund Administration. Similarly, the Ministry of Agriculture, Irrigation and Water Development has developed standard processes and methodology for estimating the rehabilitation of irrigation structures. Some of the state corporations (e.g., EGENCO and ESCOM) apply rigorous methods to estimate the costs of maintenance. EGENCO and ESCOM have issued a target for the level of spending on routine maintenance, which is 40 percent of their annual budget for operations and maintenance. They also have norms for the capital maintenance of transmission and distribution lines.

51. The resources allocated to maintenance budget are not adequate and are subject to wide fluctuations. The AERs point to repeated shortfalls in the maintenance programs of capital projects. Between 2014 and 2017 spending on maintenance was in the range 0.68 – 0.91 percent of total budgeted expenditure, excluding road maintenance financed through the fuel levy. Budget allocations for funding maintenance costs have been almost stagnant over the last three years, and are vulnerable to in-year cuts, if spending pressures in other areas are high, or revenue shortfalls occur. These tendencies are more pronounced in the case of capital maintenance expenditures (Figure 29). On the positive side, the performance contracts introduced for controlling officers from fiscal year 2013/14 include specific performance criteria covering the maintenance of assets, including reporting on the schedule of maintenance and the percentage of assets maintained. To improve compliance, these measures should be complemented by a change in the government's approach to budgeting for maintenance needs, and the development of standardized methodology for estimating maintenance costs.

Figure 29. Budget Execution for Maintenance



Source: Budget documents and Annual Financial Statements 2014/15 – 2016/17. The figures exclude road maintenance financed through the fuel levy.

10. Project Selection *(Institutional Strength – Medium; Effectiveness – Medium)*

52. MDAs have developed criteria to select capital projects and follow a process to prioritize investments, but projects can still be selected without going through this required process. Sector strategy reports include a section that establishes the linkages to the MGDS III. Sector strategies are also linked to a multi-year investment plan, from which an annual work-plan, including a short-list of priority projects, is derived. Project selection is informed by clear criteria designed to meet the minimum standards of service delivery. These standards are determined by the quality of and access to the service to be delivered. A matrix is usually developed to rank needs by required service (e.g., primary schools, health posts, piped waters, etc.) and by geographic area (e.g., national, district, community, etc.). Priorities are then filtered by those supported by development partners (off-budget projects)[36] and those requiring government funding (on-budget projects). They are further filtered for on-going and new projects, with the former given priority.

53. New projects can be proposed if the required preparatory work (e.g., cost-benefit analysis, land acquisition etc.) has been completed (see Institution 4). Eligible projects are then refined through a process of consultation between departments to ensure adequate coverage across the sector mandate. The short-listed priority projects are then packaged into a PSIP submission. In practice, the quality of this process varies considerably across MDAs. Furthermore, projects that have not been selected through this process can still be included because of a shift in priorities driven by external factors such as national disasters or political influence. The MoFEPD's PSIP Unit is mandated to have a final say in project selection and in consultation with the Budget Division, refines the short-list of priority projects into the annual development budget (see also Institution 8).

54. There is only a limited review of major project appraisals at the central level before decisions are taken to include projects in the budget. The PSIP Unit uses defined eligibility criteria to appraise project submissions from MDAs. These include strategic alignment (with the MGDS) of the project; project nature (verification that it is a capital project); project size (more than US$ 1 million for infrastructure and US$ 0.5 million for service projects); and project source (verification that the project falls within the sector mandate). This is the core of the project appraisal at the central level, which reflects a screening rather than an appraisal of projects before they enter the budgeting process. In practice, the PSIP Unit almost invariably accepts the integrity of the information provided in the project submission by the MDA, as it does not have the resources or time to scrutinize major project proposals. The Unit has noted that the quality of project appraisals linked to donor-funded investments, or to public sector entities with some

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[36] Development partners frame their interventions in line with the policy priorities of the donor government, multi-lateral institution or international Development Finance Institution (DFI). Bilateral and multi-lateral donors have developed consultation processes with host governments to align these priorities with the needs of the country receiving development assistance and mechanisms to manage aid flows to host countries.

technical capacity and their own resources (e.g., infrastructure SOEs and some statutory bodies) is much higher than central government MDAs.

55. The government maintains a pipeline of appraised projects but other projects may be selected for financing through the annual budget. Since the PSIP is a five-year rolling plan that provides details of new, ongoing, and proposed projects, it has become a powerful tool to manage the transition of projects through the pipeline. Problems posed by 'political' projects being parachuted late into the annual budgeting process can occur but the PSIP Unit have reported that this practice is now more an exception rather than a rule.

Recommendations

Issue: Ceilings are provided to MDAs too late in the budget process, allowing them insufficient time for the prioritization of projects they implement.

Recommendation 1: Provide MDAs with their spending ceilings earlier in the budget cycle, so that that can better prioritize the projects to be included in the budget.

- MDAs' expenditure ceilings should be set at the time of the strategic budget hearings in November to allow them to prioritize capital projects which are not externally financed. Ceilings could be adjusted in line with the MTEF prepared later (BD/EPD, November 2018).

Issue: Budget documentation is extensive but much information regarding capital projects is not included.

Recommendation 2: **Expand the budget documentation to capture all public investment projects:**

- Improve the information on "off-budget" expenditures in consultation with the NGOs/bilateral donors who implement these projects; and break down expenditure between development and recurrent spending (BD/EPD; June 2019).
- Develop reporting mechanisms for PPP projects by MDA, including data on guarantees and other contingent liabilities (BD with the assistance of the PPPC; December 2019).
- Include financial reports on SOEs, covering their financial status and investment activities (see Recommendation 4) in the budget documentation (BD/Accountant General/ Department of Statutory Corporations, OPC, June 2020).

Issue: Information on total projects costs and multi-year commitments is not included in the budget documentation.

Recommendation 3: Include information on total project costs and multi-year commitments in the budget.

- Publish in the budget information on (i) total estimated project costs; (ii) previous budget years' actual spending; (iii) estimated spending in the current budget year; (iv) committed expenditures for the next budget year; (v) estimated spending and contractual commitments for the MTEF outer-years; and (vi) the balance of funding required to complete each project (BD/EPD-PSIP unit; March 2019).

Issue: No standardized methodology or guidelines have been issued to estimate routine and capital maintenance needs. Spending on maintenance is inadequate, vulnerable to in-year cuts, and outturns cannot be easily tracked in fiscal reports.

Recommendation 4: Revise existing processes for estimating and disclosing information on maintenance requirements and costs.

- Develop standard guidelines on the estimation of maintenance requirements and their cost, and prevent their reallocation during budget execution (BD, December 2019).
- Provide more consistent information in budget execution reports and the annual financial statements on maintenance spending (BD and AGD, June 2020).

D. Delivering Productive and Durable Public Assets

11. Procurement *(Institutional Strength – Low; Effectiveness – Low)*

56. The procurement legislation contains adequate provisions on open and competitive tendering, barring exceptional circumstances in which more restrictive tendering is permitted. The new Public Procurement and Disposal of Assets Authority (PPDA) Act which became effective in December 2017[37] prescribes open tendering as a default method, with exceptions provided for other methods based on financial thresholds and conditions that justify the use of less competitive methods. These methods include restricted tendering and single-source methods of procurement under specified circumstances. The PPDA Act has enhanced provisions on the institutional and regulatory status of the Authority, and for the publication and transparency of information. The supporting regulations and instructions for the new Act have yet to be developed.

57. In practice, however, the procurement process is far from effective. PPDA assesses that overall compliance with the legal framework across entities has been variable has fallen from 65 to 15 percent.[38] Even in MDAs where compliance is relatively better, uneconomic and non-competitive procurement is common, as confirmed by the annual audit reports published by the NAO. The ongoing procurement assessment of Malawi undertaken by the World Bank using the revised *Methodology for Assessing Procurement System (MAPS II)* concludes that for FY 2016/17 only 15 percent of procurement went through open tender for cases reviewed by the PPDA.[39]

[37] The new Act replaces the earlier Public Procurement Act (PPA) 2003.

[38] Reported in discussions during a meeting with the Acting Director, PPDA.

[39] This information is based on the data shared by the authorities with the MAPS team. The MAPS report is still at a draft stage. However, the World Bank shared some of its key findings with the mission.

This disappointing result can partly be attributed to the lack of experience of MDAs in running open tender and competitive bidding processes, and limited internal capacity to monitor the quality and integrity of the processes. On the other hand, procurement of donor-funded projects that account for around 85 percent of the share of public investment, typically follow donor-based procurement rules that require the use of competitive methods.

58. Though publication of information on procurement opportunities and awards is required by law, compliance has been generally poor. The PPDA website has very little information on procurement activities. The MAPS II assessment has also noted the absence of reliable and comprehensive data on procurement. Going forward, the PPDA, with support from development partners, plans to implement an e-Procurement system and revamp the agency's website. These reforms should enable greater disclosure and transparency of procurement information, which is a mandatory under the PPDA Act.

59. Public procurement is not adequately monitored and a comprehensive procurement database does not exist. PPDA does not systematically collect, maintain and publish information on public procurement for monitoring the performance of procuring entities in terms of efficiency and compliance with the legal framework. It does not have a well-functioning web portal that would typically host such information. Systematic procurement audits/reviews are not carried on a regular basis, a gap that has been attributed to resource and skills deficits. The last review that was carried out was for fiscal year 2014/15, and was limited to a sample of 20 entities. Occasionally, specials audits have been carried out by the PPDA—as in the case of City Councils and Central Hospitals, Malawi Revenue Authority, and Blantyre Water Board—but these audits are in response to specific requests received from the entities and are not systematic. The NAO in its annual audit report includes cases of non-compliance with the procurement regulations, but no comprehensive procurement audit or an evaluation of major capital projects has been undertaken in the recent past.

60. The procurement complaints and review process provided for in the legal framework is not implemented in a comprehensive or transparent manner. The 2003 Public Procurement Act provided for a formal compliant/appeal process and contained provisions for judicial review. It also prescribed procedures and timelines for these complaints to be addressed. The effectiveness of this process, however, cannot be ascertained as information on the review of complaints and the outcomes is not publicly available. The private sector survey carried out as part of MAPS II suggests that three-quarter of the respondents did not consider the process to be fair and trustworthy. The PPDA Act contains similar provisions and more stringent requirements on the publication of information. It does not address, however, the issue of independence of the review body which is to be appointed by the Procurement Authority. This is an issue that is expected to be clarified in the supporting regulations that are yet to be developed.

12. Availability of Funding *(Institutional Strength – Low; Effectiveness – Low)*

61. The budget releases are based on cash-flow forecasts that are prepared annually by the MDAs and not updated regularly during the year. These forecasts, though aligned with the approved budget, tend to be front-loaded and are not reliable. There is little systematic planning and assessment of evolving cash needs over the course of the budget year. The cash management unit, established in 2016, has started consolidating the cash forecasts received from MDAs and updating them monthly but only for the proposed inflows—revenues and financing. The cash forecasting practices in the MoFEPD and the MDAs are at a basic level. East AFRITAC has been providing support to the on-going reforms in the areas of cash forecasting and management.[40]

62. The practice of monthly fund releases is inconsistent with efficient expenditure planning. The PSIP monitoring report for 2015 points to a misalignment of funding levels and planned cash flows for most projects. MoFEPD exercises commitment controls at the centralized level through monthly budget releases. These controls define ceilings for both the incurrence of commitments and cash that is available for payments for a specific month. The monthly time horizon of the budget releases severely constrains the ability of MDAs to plan and commit expenditures in advance. Furthermore, in view of the frequent underperformance of revenues and/or difficulties in providing financing, MoFEPD resorts to cash rationing that restricts expenditure plans. As a result, the total monthly budget releases do not prioritize development expenditure and are typically lower than the annual budget appropriations. Figure 30 compares the approved budget and funding releases for fiscal years 2015/16 and 2016/17. The left-side chart shows the percentage deviation from the approved budget for all MDAs during these two years, while the right-side chart highlights the MDAs where these shortages were most acute. Although the overall release of funding is closer to the approved budget for FY 2016/17, the MDAs that are responsible for the largest share of development expenditure were more severely affected. [41]As a result, the number of PSIP projects that had to be suspended for lack of adequate funding increased from 17 in 2015/16 to 95 in 2016/17.

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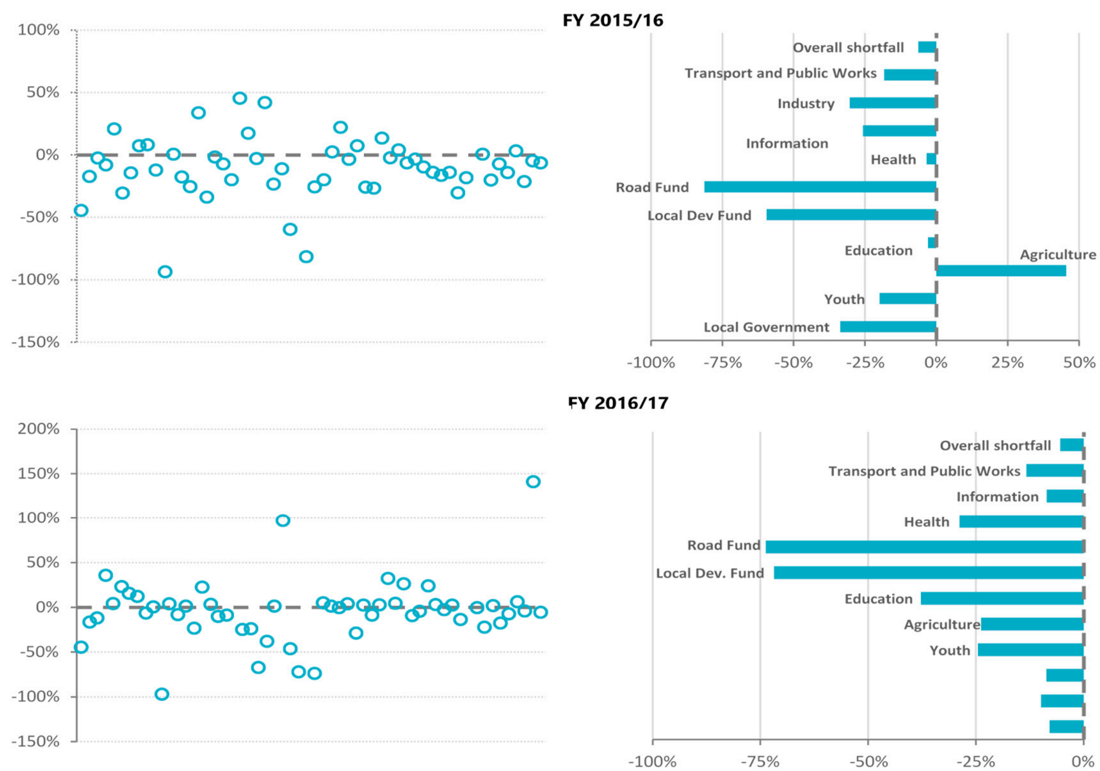
[40] More detailed discussion of these issues is available in an East AFRITAC report, *Malawi: Strengthening Cash Management and TSA Banking Arrangements,* Paul Seeds and John Gardner, May 2017.

[41] The mission could not access funding data separately for recurrent and development expenditure. MoFEPD officials suggested that some of these shortfalls could also be attributed to delays in disbursements by donors and low level of execution by entities.

Figure 30. Comparison of Approved Budget versus Funding Releases



Source: MoFEPD

63. Weak cash management practices, cash rationing, and a cumbersome system of monthly budget releases have led to a significant build-up of arrears. The end-June 2017 stock of central government arrears stood at MK 316.5 billion, or about 6.8 percent of GDP. The NAO has recently concluded an exercise on the verification of arrears, certifying MK 197.6 billion for payment, 37 percent of which relates to civil works.[42] About 35 percent of the certified arrears relate to capital investment projects undertaken by the Road Fund Administration.

64. Most of the external financing is held at the Reserve Bank of Malawi (RBM) and is part of the main government bank account structure. The donor project accounts held at the RBM and are included in the daily government position determined by the Bank. These holding accounts are linked to specific operating accounts in the commercial banks that operate on a credit ceiling authority (CCA) basis.[43] There are, however, some donor-funded accounts at commercial banks which do not have a corresponding holding account at the RBM. The Accountant General's Department has completed a survey of the government's bank accounts as

[42] Consolidated Audit Report on the Verification of Arrears Owed by Government for the period ended December 2017, National Audit Office, February 2018.

[43] The CCA system restricts the use of operating accounts to a specified limit issued by the Treasury, and is comparable to a zero-balance account structure.

part of its ongoing initiative on the rationalization of these accounts. The results of this survey, when implemented, should significantly improve the oversight and control over government funds.[44]

13. Portfolio Management and Oversight *(Institutional Strength – Medium; Effectiveness – Low)*

65. While most major projects are subject to monitoring during project implementation, there are shortcomings in this procedure. Project monitoring is done centrally by the EP&D Department of the MoFEPD that requires projects to report quarterly on their financial and physical progress. A centralized database has been developed for monitoring the PSIP, under the management of the PSIP Unit, EP&D, and the MoFEPD's budget division. This database contains information on on-going projects and the pipeline of proposed projects. The information in the PSIP database however, is currently of a variable quality and incomplete, but improvements are expected as the database is still in its development phase (Box 5). Though the compliance rate of quarterly reporting has improved over the last couple of years, the data quality is not consistent across projects as most MDAs do not provide updates on a regular basis. The data are also incomplete as they do not include projects being implemented by SOEs as well as some donor-funded and off-budget projects. As a result, comprehensive reports on the financial and operational performance of the public investment portfolio are not available.

66. In the absence of a robust monitoring and evaluation methodology, the management and oversight of investment projects tends to be unreliable and reactive. The focus of monitoring is on the approved annual budget, and projects are not tracked against their total costs compared to budget, and their anticipated completion time. There is also little evidence to suggest that the information generated from the PSIP database is used systematically by decision makers to take action if projects get delayed or go off track. The expertise in conducting reviews and systematic assessments of projects is low, and the guidance issued by EP&D focuses on the preparation and appraisal of projects.[45]

67. Reallocations between projects that are executed through the budget are not very frequent and can only be made within the limits prescribed in the PFM legal framework. Institution 8 discusses the restrictions on budgetary reallocations in the PFMA. Reallocations between projects are based on requests from the implementing MDAs, and are done with the approval of the MoFEPD and the concerned donor, as applicable. These are generally affected during the mid-year budget reviews when the inter- and intra-sectoral reallocation of resources

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[44] The next steps were discussed in a recent FAD report, *Malawi: Strengthening Financial Controls*, M. Alves et.al., April 2018.

[45] The PSIP Preparation Handbook and the PSIP Process Management and Appraisal Manual contain little guidance on project monitoring and implementation.

take place. Reallocations, however, do not arise out of systematic monitoring of project implementation, and are often not based on transparent procedures. There is no established process for weeding out non-performing projects to create room for new ones.

Box 5. PSIP Database - Improving Management Oversight of Public Investment

The database is an online system developed with support from JICA as a centralized repository for public investment projects. It is managed by the PSIP unit of EP&D in MoFEPD and has been operational since 2015, covering the entire project cycle. The PSIP contains project-wide log frames, and provision for uploading project documents. Excel templates have been developed for MDAs to upload quarterly information on the physical and financial progress of projects. It is accessible to MDAs and other departments of the MoFEPD. User manuals have been developed and extensive training has been given to the end-users on using and maintaining the system. The database has developed formal procedures for entities to share information on public investment and is developing as a central repository of projects and inter-agency review. However, the information sharing is relatively limited and can be better coordinated. For the PSIP to develop as a fully effective central platform for management oversight of public investment projects the following issues need to be addressed:

- **Coverage** of project portfolio is limited and quarterly updates are not provided by project implementation units on a regular basis.
- **Reporting** functionalities do not cover the entire project cycle, and do not adequately support the monitoring framework.
- **Sustainability** could become an issue as the support from JICA has come to an end.
- **Usage** amongst stakeholders both within and outside of the MoF is still limited.

To address these issues, the MoFEPD should implement a program of improvements to the PSIP over the next two years (see also Recommendation 11):

- Develop a plan for preparing an inventory of all public investment projects and progressively improving their coverage in the database.
- Enforce quarterly reporting for all projects.
- Improve the reporting functionality to support the monitoring function by tracking progress against total project costs, and the projected budget over the lifecycle of projects.
- Ensure sustainability by allocating necessary resources to support maintenance, further development and implementation of the database, and capacity building in the MDAs and the PSIP Unit.
- Check against development of parallel systems on project monitoring by MDAs and streamline reporting format currently being used by the OPC and the MoFEPD's Budget department.
- Assess the system design to ensure workflow integration between sectoral planning and budget so that selection of projects in the MTEF come from the PSIP database. This will encourage usage of the system.
- Start publishing a consolidated annual report on financial and non-financial information for major capital projects on the MoFEPD website.
- Continue to provide training and familiarization programs for end-users in MDAs on using the system.
- Ensure the technical specifications for the proposed new IFMIS have a provision for interface with the PSIP database and consider developing an interface with the aid management platform.

Source: EP&D and FAD staff

68. Ex-post reviews and evaluations of completed investment projects are generally not conducted, except for some donor-funded projects. Though project completion reports are prepared by some MDAs, these include little evaluation of project costs, deliverables, and outputs. As a result, the government lacks information on the financial or operational performance of recently completed projects. The legal framework does not require projects to be subjected to ex-post review. On the positive side, the Construction Sector Transparency Initiative (COST)[46] has conducted an independent review of 28 projects in the roads, housing, water, and energy sectors. It is, however, too early to assess the impact of this study, if any, on project implementation policies and procedures.

14. Management of Project Implementation *(Institutional Strength – Low; Effectiveness – Low)*

69. Project management arrangements vary across sectors and depend on the source of financing. Most donor-funded projects have disbursement preconditions that require the establishment of project implementation units. The practices vary for domestically-funded projects. In some MDAs, a senior official, generally the Director of Planning, may be responsible for the management and implementation of several projects. Except for the roads sector that has more robust arrangements, there is no consistent system for managing implementation, or guidelines that prescribe minimum standards for project management. For projects involving civil works, the Director of Buildings in the Ministry of Transport and Public Works is responsible for supervising the work of the contractors. Ministries such as Education and Health have established a dedicated unit for infrastructure management that coordinates the implementation of construction projects. These overlapping reporting lines and unclear accountability arrangements limit the effectiveness of project monitoring and management. In most instances, a high-level project schedule is prepared prior to budget approval, but detailed implementation plans are usually not prepared until after the budget has been approved.

70. There are no consolidated and consistent rules and procedures for managing project adjustments that are applied across government. Project adjustments for donor-funded projects are based on the development partner's rules and procedures. As reported by the PSIP unit, there are frequent cases of time and cost overruns that require project adjustments. These are largely done to accommodate funding shortfalls from the budget or donors or changes in procurement contracts. In case of civil works, implementing units can allow variations up to 10 percent of contract value, up to 15 percent with the approval of the MoFEPD, and beyond 15 percent with the approval of the PPDA. The Ministry of Health similarly provides for a contingency of 10 percent for major capital investments, and a typical overrun threshold of 15 percent is tolerated for such projects. There is however, no systematic recording of the

[46] COST (http://www.constructiontransparency.org/home) is a country based initiative that is aimed at raising the standards of transparency and accountability in the management of public infrastructure internationally. Apart from Malawi, COST is active in some other African countries including Botswana, Ethiopia Tanzania, Uganda, and Zambia.

reasons (such as price adjustments, changes in the scope of works, or an extension of the construction period) for these variations. Project adjustments are thus considered in the context of procurement or adherence to the budget, as opposed to the needs of the project. There is no formal process for re-examining the economic and social rationale for a project in the face of significant changes in costs or the demand for the services to be delivered by the project.

71. Ex-post audits of major projects are not routinely conducted except for donor-funded projects that are required to be audited as part of the project conditions. The NAO, in recent years has concentrated on clearing the backlog in annual financial audits. It also has resource and capacity constraints that restrict its ability to systematically audit capital projects. As a result, only some projects are subjected to ex-post audit, and these reports are not published consistently. In the case of the Local Development Fund Projects, the audits do provide feedback on the effectiveness of the entire project cycle and opportunities for improving project implementation practices (see also Institution 3).[47] But there have been delays in reviewing the NAO reports by the Public Accounts Committee of the Parliament, and the preparation of the Treasury Minutes by MoFEPD based on the PAC's recommendations, which undermine the oversight function of the legislature.

15. Monitoring of Public Assets (*Institutional Strength – Medium; Effectiveness – Low*)

72. The current financial regulations require that asset registers be maintained and kept up-to date. The Treasury Instructions provide that these registers be prepared for all types of fixed assets, consolidated by the relevant MDAs, and updated quarterly for inclusion in the financial statements prepared by the Accountant General and submitted to the Office of the President and Cabinet. These instructions also require that assets be properly recorded, accounted for, and safeguarded against potential loss or destruction. Finally, the instructions state that the authorities should include information on the government's assets, liabilities, and net financial position in the annual financial statements.

73. Despite these regulations, asset management remains weak in Malawi. Asset registers are not systematically maintained or updated and if they are, practices vary from one MDA to the other.[48] Moreover, the NAO's reports have systematically pointed to unsatisfactory asset management and highlighted the failure of MDAs to maintain the required asset registers. Currently, Malawi uses cash-basis for its accounts and financial reporting. Consequently, nonfinancial assets are not recorded in the balance sheet, nor are depreciation expenses

[47] Performance Audit report on the Management and Implementation of Local Development Fund Projects, National Audit Office, May 2017. The audit was supported with funding from the government and development partners, and covered fiscal years 2010/11 to 2013/14.

[48] For example, asset registers are maintained and updated in the Ministry of Works by all the relevant departments and in some departments of the Ministry of Transport, while none exists in the Ministry of Health.

reflected in the operating statement. This cash-flow oriented accounting system overlooks the true value of public assets.

74. The authorities have taken some initial steps to reinforce asset management which should be pursued in the coming years. The Accountant General has circulated a template to MDAs for reporting on assets for the consolidation of the 2017/18 financial statements. The authorities plan to activate an asset module in the IFMIS to enable the systematic registration of non-financial assets. Moreover, they have expressed their intention to move towards accrual accounting in the coming years. Such a reform would support public investment decision-making, including the reporting on contingent liabilities relating to SOEs or PPPs, and better budgeting for maintenance. However, the implementation of accrual accounting is likely to be a protracted process, and should be approached in a phased manner, starting with a complete inventory of the existing assets (financial and non-financial) and their valuation. Enforcing the current regulations on assets registers and valuation is thus critical for pursuing this reform.

Recommendations

Issue: The legal framework for procurement is not implemented effectively, and the process is insufficiently transparent.

Recommendation 1: Prepare a detailed implementation plan for improving transparency in the procurement process.

- Publish information on procurement activities and analytical reports to comply with the new law (PPDA, October 2018)
- Ensure independence and transparency of the complaint review mechanisms, and regularly publish information on the outcome of specific cases (PPDA, December 2018)
- Conduct regular procurement reviews/audits in close collaboration with the National Audit Office (PPDA, June 2019).

Issue: Cash forecasts are short-term, and budget allotments are made in an unpredictable manner, leading to significant uncertainty surrounding the funding of capital projects.

Recommendation 2: Ensure that funding for capital spending is made available in a consistent and timely manner.

- Improve cash flow forecasting to include committed expenditures for the current and future years (BD, October 2018)
- Move from monthly to quarterly cash releases for selected capital expenditure categories (BD, July 2018).
- Inform MDAs sufficiently in advance of upcoming and anticipated spending cuts (BD, July 2018)

Issue: The management oversight and monitoring of the public investment portfolio has gaps in terms of coverage, reporting functionalities, and linkages with the budgeting and financial reporting systems.

Recommendation 3: Increase the usefulness of the PSIP database as a platform for the oversight and monitoring of investment projects.

- Undertake an independent audit of the existing PSIP, with a focus on expanding its coverage and effectiveness, increasing the regularity and timeliness of MDAs' quarterly reports on capital projects, enhancing the functionality of the PSIP by tracking progress against total project outcomes and costs, and reconciling information in the database with the selection of projects in the budget (EP&D, June 2019)
- Ensure that the technical specifications for the new IFMIS provides for interfaces with the PSIP and the aid management platform (EP&D, October 2018)
- Pilot ex-post reviews/audits of major capital projects in collaboration with the NAO (EP&D, June 2019)
- Publish a consolidated annual financial report on major capital projects (EP&D, June 2019)

Issue: The practice of maintaining and updating asset registries differs from one ministry to the other and there is no consolidated information available on the value of assets or their depreciation.

Recommendation 4: **Improve reporting on non-financial assets**

- Require MDAs to maintain and update a register of the stock and value of non-financial assets, with the information being built up on a step-by-step basis (Accountant General, with support of MDAs; June 2021)
- Publish information on non-financial assets in the government's annual financial statements, based on data that are available in the register (Accountant General; ongoing)

Annex I. Suggested Improvements in the Legal Framework and Capacity Building

Legal Framework

75. Malawi's legal framework for public investment management should be strengthened in several areas. A review of the PFM Act is underway, and is expected to be completed and presented to Parliament by November 2018. This review provides an opportunity to address some of the gaps that have been identified under the various institutions in Part III of this report, and are summarized below:

- **The authorities should adopt a realistic approach to revisions in the PFM legal framework.** The planned implementation of sophisticated reforms is likely to divert attention and the already scarce resources, from core and more impactful reforms. This includes the ongoing initiative on program-based budgeting, the planned transition to accrual accounting, the full deployment of MTEFs, among others.

- **Attention should be paid to strengthening the public investment management framework.** In particular, provisions should be added to the new PFMA requiring a feasibility study to be systematically carried out for all large projects financed through the budget. It could also include provisions on ex-post reviews and audits of all completed capital projects. In addition, supporting regulations, guidelines and procedures, should be developed to provide detailed guidance on project preparation, costing, PPP evaluation and risk assessment, project appraisal and selection; and project monitoring and evaluation.

- **Incorporating provisions for a rule-based fiscal framework.** This can be done without necessarily having a separate fiscal responsibility legislation, by adding a section in the new PFMA, defining a permanent fiscal rule, how it will be implemented, and its oversight arrangements. The operational details should be left to secondary legislation, for instance, financial regulations or treasury instructions.

- **While the existing legal framework for PPPs is largely adequate, it does not require fiscal risk analyses to be systematically conducted and disclosed.** This requirement could be incorporated through provisions in the new PFMA, or an amendment to the PPP law. The disclosure of all PPP transactions would also be mandated. In implementing the ambitious investment projects identified in the MGDS, the authorities have signaled the intention to use PPPs as an alternative financing mechanism. This is likely to expose the authorities to potentially significant fiscal risks, and it may be exacerbated by limited implementation capacity within government, given the lack of experience in this area. Recommendation 2 suggests providing funding for capacity development and external expert support through the P-FRAM tool.

- **Defining institutional roles and responsibilities for SOE fiscal oversight.** The current oversight of SOEs is fragmented and weak. The PFM Act should assign clear roles and responsibilities between SOEs' Boards, line ministries, OPC, and other intervening entities, to allow for the MoFEPD to focus more sharply on its SOEs' fiscal oversight function**.**

- **The supporting regulations and instructions to the new PPDA Act should be developed to guide the implementation of the Act.** The focus would be to ensure that a greater proportion of public tenders are awarded through an open and competitive process.

Capacity Building

76. The investment ambitions of the MGDS are likely to test the existing capacities. For almost three decades, public investment in Malawi has averaged about 5.5 percent of GDP. The MGDS plans to spend US$ 1.2 billion on capital projects over the next five years, over 19 percent of GDP. It also envisages using alternative financing mechanisms such as PPPs. This will create systemic pressures that can be alleviated by taking a more disciplined and risk-based approach, leveraging improved information systems, and strengthening a number of critical functions:

- **Initially this can be done by selective use of external consultants and experts**, as is currently the case for most donor-funded projects. Particular emphasis could be placed on building the capacity for reinforcing the PSIP usefulness as a basis for budgeting, conducting rigorous project appraisal, and undertaking PPPs for which the existing capacity is relatively limited.
- **In the medium to longer-term, a PIM staff development strategy will be required.** It should be based on an assessment of the skills mix required to implement the PSIP. This assessment can build on existing and future functional review as well as on portfolio assessments carried out by major development partners. Based on these findings and the prospective skills need, a sustainable capacity building strategy should be developed, with a focus on critical PIM functions such as project preparation, appraisal, land valuation and acquisition, procurement, project and contract management.
- **Strengthening coordination within MoFEPD, and with MDAs would be critical for a more efficient public investment management.** For example, improving coordination would allow for the department responsible for the PSIP database, and the department responsible for the aid database, to use and reconcile each other's data and reduce data inconsistencies. Furthermore, there appears to be significant duplication of effort in project management, for example, the ongoing development of multiple monitoring and evaluation systems in MDAs despite the existence of the PSIP database.

Annex II. Example of a Multi-Annual Commitment Report (Annex to the Budget)

	Project name/number of contracts[1] **A**	Contract number **B**	Expenditure to date **C**	Budget year 1 **D**	MTEF year 2 **E**	MTEF year 3 **F**	Total contract value **G**	Remaining budget funding required **G minus (C+D+E+F)**
1.MTEF Ceiling								
2.Total Project commitments (listed below)								
Project a								
Project b								
……								
….								

[1] Number of contracts or smaller projects

Fiscal Affairs Department

International Monetary Fund
700 19th Street NW
Washington, DC 20431
USA
http://www.imf.org/capacitydevelopment