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Report No: PAD2819

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED GRANT

IN THE AMOUNT OF SDR 72.9 MILLION
(US\$100 MILLION EQUIVALENT)

TO THE

REPUBLIC OF MALAWI

FOR A

GOVERNANCE TO ENABLE SERVICE DELIVERY PROJECT

April 9, 2020

Governance Global Practice
Africa Region

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CURRENCY EQUIVALENTS

(Exchange Rate Effective February 29, 2020)

Currency Unit = Malawi Kwacha (MWK)

MWK 735.6 = US\$1

US\$1 = SDR 0.728

FISCAL YEAR

July 1 - June 30

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ABBREVIATIONS AND ACRONYMS

ADC	Area Development Committee
AIP	Annual Investment Plan
ARICS	Audit Recommendation Implementation Committee
BP	Bank Policy
CAS	Country Assistance Strategy
CDF	Constituency Development Fund
CEC	Citizen Engagement Committee
CIAU	Central Internal Audit Unit
CPF	Country Partnership Framework
CSO	Civil Society Organization
DA	Designated Account
DDF	District Development Fund
DDP	District Development Plan
DFID	United Kingdom Department for International Development
DHRMD	Department of Human Resource Management and Development
DoF	Director of Finance
ESMF	Environmental and Social Management Framework
FM	Financial Management
FY	Fiscal Year
GBV/SEA	Gender-Based Violence and Sexual Exploitation and Abuse
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GESD	Governance to Enable Service Delivery
GNI	Gross National Income
GoM	Government of Malawi
GPI	Grant for Performance Improvement
GRM	Grievance Redress Mechanism
HCI	Human Capital Index
ICT	Information and Communication Technology
IDA	International Development Association
IFMIS	Integrated Financial Management Information System
IGFTS	Intergovernmental Fiscal Transfers
IIAG	Ibrahim Index of African Governments and Global Competitiveness Index
IMF	International Monetary Fund
IPF	Investment Project Financing
IRR	Internal rate of Return
LA	Local Authority
LASCOM	Local Authority Service Commission
LDF	Local Development Fund
LGA	Local Government Act
LGAP	Local Government Accountability and Performance
M&E	Monitoring and Evaluation
MAC	Minimum Access Conditions
MASAF	Malawi Social Action Fund

MDA	Ministry, Department, Agency
MGDS III	Malawi's Third Growth and Development Strategy
MoFEPD	Ministry of Finance, Economic Planning, and Development
MoLGRD	Ministry of Local Government and Rural Development
MSSRLP	World Bank Social Support for Resilient Livelihoods Project
NAO	National Audit Office
NDP	National Decentralization Policy
NESP	National Education Sector Plan
NLGFC	National Local Government Finance Committee
NNR	Net National Revenues
ODA	Official Development Assistance
ODI	Overseas Development Institute
OP	Operational Policy
OPC	Office of the President and Cabinet
ORT	Other Recurrent Transactions
OVI	Objectively Verifiable Indicator
PAD	Project Appraisal Document
PBG	Performance-based Grant
PDO	Project Development Objective
PFM	Public Financial Management
PIM	Project Implementation Manual
PIP	Performance Improvement Plan
PIU	Project Implementation Unit
PM	Performance Measures
PP	Procurement Plan
PPSD	Project Procurement Strategy for Development
PS	Principal Secretary
PTR	Pupil-teacher Ratio
RPF	Resettlement Policy Framework
SDR	Special Drawing Rights
SORT	Systematic Operations Risk-Rating Tool
SSA	Sub-Saharan Africa
STEP	Systematic Tracking and Exchanges in Procurement
ToR	Terms of Reference
VDC	Village Development Committee
WASH	Water, Sanitation and Hygiene
WB	World Bank
WBG	World Bank Group
WEF	World Economic Forum
WGI	Worldwide Governance Indicators



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DATASHEET

BASIC INFORMATION

Country(ies)	Project Name	
Malawi	Malawi Governance to Enable Service Delivery Project	
Project ID	Financing Instrument	Environmental Assessment Category
P164961	Investment Project Financing	B-Partial Assessment

Financing & Implementation Modalities

<input type="checkbox"/> Multiphase Programmatic Approach (MPA)	<input type="checkbox"/> Contingent Emergency Response Component (CERC)
<input type="checkbox"/> Series of Projects (SOP)	<input type="checkbox"/> Fragile State(s)
<input type="checkbox"/> Disbursement-linked Indicators (DLIs)	<input type="checkbox"/> Small State(s)
<input type="checkbox"/> Financial Intermediaries (FI)	<input type="checkbox"/> Fragile within a non-fragile Country
<input type="checkbox"/> Project-Based Guarantee	<input type="checkbox"/> Conflict
<input type="checkbox"/> Deferred Drawdown	<input type="checkbox"/> Responding to Natural or Man-made Disaster
<input type="checkbox"/> Alternate Procurement Arrangements (APA)	

Expected Approval Date	Expected Closing Date
30-Apr-2020	30-Sep-2025

Bank/IFC Collaboration

No

Proposed Development Objective(s)

To strengthen Local Authorities' institutional performance, responsiveness to citizens and management of resources for service delivery.

Components

Component Name	Cost (US\$, millions)
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Performance-Based Financing for Service Delivery	73.20
Strengthening Inter-governmental Accountability Systems	3.80
Local Government Performance Improvement Support	18.00
Adaptive Management and Innovation Support	5.00

Organizations

Borrower: Republic of Malawi
 Implementing Agency: National Local Government Finance Committee

PROJECT FINANCING DATA (US\$, Millions)

SUMMARY

Total Project Cost	100.00
Total Financing	100.00
of which IBRD/IDA	100.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	100.00
IDA Grant	100.00

IDA Resources (in US\$, Millions)

	Credit Amount	Grant Amount	Guarantee Amount	Total Amount
Malawi	0.00	100.00	0.00	100.00
National PBA	0.00	100.00	0.00	100.00
Total	0.00	100.00	0.00	100.00

Expected Disbursements (in US\$, Millions)



WB Fiscal Year	2020	2021	2022	2023	2024	2025
Annual	6.00	16.00	21.00	26.00	31.00	0.00
Cumulative	6.00	22.00	43.00	69.00	100.00	100.00

INSTITUTIONAL DATA

Practice Area (Lead)

Governance

Contributing Practice Areas

Education, Health, Nutrition & Population, Social Protection & Jobs

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	● Substantial
2. Macroeconomic	● Substantial
3. Sector Strategies and Policies	● Substantial
4. Technical Design of Project or Program	● Substantial
5. Institutional Capacity for Implementation and Sustainability	● Substantial
6. Fiduciary	● Substantial
7. Environment and Social	● Moderate
8. Stakeholders	● Substantial
9. Other	
10. Overall	● Substantial



COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

Yes No

Does the project require any waivers of Bank policies?

Yes No

Safeguard Policies Triggered by the Project

	Yes	No
Environmental Assessment OP/BP 4.01	✓	
Performance Standards for Private Sector Activities OP/BP 4.03		✓
Natural Habitats OP/BP 4.04		✓
Forests OP/BP 4.36		✓
Pest Management OP 4.09		✓
Physical Cultural Resources OP/BP 4.11	✓	
Indigenous Peoples OP/BP 4.10		✓
Involuntary Resettlement OP/BP 4.12	✓	
Safety of Dams OP/BP 4.37		✓
Projects on International Waterways OP/BP 7.50		✓
Projects in Disputed Areas OP/BP 7.60		✓

Legal Covenants

Sections and Description

Schedule 2, Section I.A.1 of the Financing Agreement. The Recipient shall establish within two (2) months from the Effective Date and thereafter, maintain at all times during the implementation of the Project, the Project Steering Committee with a mandate, composition and resources satisfactory to the Association and responsible, at the central government level, for providing overall policy guidance for, and supervision of, Project implementation.

Sections and Description

Schedule 2, Section I.A.2 of the Financing Agreement. The Recipient shall establish within two (2) months from the Effective Date and thereafter, maintain at all times during the implementation of the Project, the Project Technical Committee with a mandate, composition and resources satisfactory to the Association and responsible and responsible for coordinating Project implementation across all relevant ministries, departments and agencies at the



central government level.

Sections and Description

Schedule 2, Section I.A.3 of the Financing Agreement. The Recipient: (a) has designated NLGFC as the implementing agency for the Project and responsible: (i) for overall Project management, implementation and coordination of Project activities; and (ii) for specific Project implementation unit functions, including appointing a senior officer in the NLGFC to act as overall Project Coordinator responsible for day-to-day implementation of the Project, and to oversee a team assembled and responsible for financial management, procurement, monitoring and evaluation, reporting and safeguards for the Project; and (b) shall ensure that NLGFC: (i) maintains, at all times during the implementation of the Project, the implementing arrangements described in subparagraph (a)(ii) above with a mandate, composition and resources satisfactory to the Association with responsibility for day-to-day implementation of the Project; and (ii) within three (3) months from the Signature Date, hires a dedicated Project procurement specialist with qualifications, experience, and terms of reference satisfactory to the Bank.

Sections and Description

Schedule 2, Section I.C.1 of the Financing Agreement. Not later than May 30 in each Fiscal Year (or one month after the Effective Date for the first year of Project implementation), the Recipient shall prepare or cause to be prepared for the purpose of forwarding to the Association: (i) a draft annual work plan and budget for the Project (including Training and Operating Costs) for the subsequent Fiscal year of Project implementation, of such scope and detail as the Association shall have reasonably requested; and (ii) a description of the instruments required by the ESMF and/or RPF for the implementation of the activities and the proposed budget for implementation of said instruments, all to be included in the draft annual work plan and budget.

Conditions

Type	Description
Effectiveness	The Project Implementation Manual has been adopted in accordance with the provisions in Section I.B.1 of Schedule 2 to the Financing Agreement.
Disbursement	No withdrawal shall be made under Category 1(a) in Section III.A of Schedule 2 to the Financing Agreement unless and until: (i) the amount of funds allocated to the DDF in the approved budget for FY 2020-2021 is, at a minimum, equivalent to MWK 3.2 billion as per the 2019-2020 financial year budget, adjusted by CPI; and (ii) 100% of the amount referred to in (i) is disbursed by the end of the first month of the fourth quarter of FY 2020-2021.
Disbursement	No withdrawal shall be made under Category 1(b) in Section III.A of Schedule 2 to the Financing Agreement unless and until: (i) the amount of funds allocated to the DDF in the approved budget for FY 2021-2022 is, at a minimum, equivalent to the amount in the 2020-2021 financial year budget, adjusted by CPI; and (ii) 100% of the amount referred to in (i) is disbursed by the end of the first month of the fourth quarter of FY 2021-2022.



Type Disbursement	Description No withdrawal shall be made under Category 1(c) in Section III.A of Schedule 2 to the Financing Agreement unless and until: (i) the amount of funds allocated to the DDF in the approved budget for FY 2022-2023 is, at a minimum, equivalent to the amount in the 2021-2022 financial year budget, adjusted by CPI; and (ii) 100% of the amount referred to in (i) is disbursed by the end of the first month of the fourth quarter of FY 2022-2023.
Type Disbursement	Description No withdrawal shall be made under Category 1(d) in Section III.A of Schedule 2 to the Financing Agreement unless and until: (i) the amount of funds allocated to the DDF in the approved budget for FY 2023-2024 is, at a minimum, equivalent to the amount in the 2022-2023 financial year budget, adjusted by CPI; and (ii) 100% of the amount referred to in (i) is disbursed by the end of the first month of the fourth quarter of FY 2023-2024.



I. STRATEGIC CONTEXT

A. Country Context

- 1. Malawi is a densely populated agriculture-dominated economy that is one of the poorest countries in the world.** Malawi's per capita Gross National Income (GNI) was US\$360 in 2018 and around 70 percent of the population lives below the international poverty line of US\$1.90 per day. The GNI grew at an annual average of around 1.5 percent between 1995 and 2014, which is below the average of 2.8 percent in non-resource African economies during the last twenty years. Agriculture contributes 28 percent of Malawi's gross domestic product (GDP), over 80 percent of the national export earnings and absorbs 64 percent of the country's workforce, but its productivity is undermined by weather-related shocks and limited crop diversity. In 2017, 50 percent of the export earnings were from tobacco (28 percent), sugar (8 percent), tea (8 percent) and edible nuts (6 percent).¹ Malawi's Third Growth and Development Strategy (MGDS III) aims to break the cycle of persistently low agricultural productivity and limited opportunities for non-farm self-employment, which together are considered the main proximate determinants of stagnant poverty levels in Malawi.²
- 2. Exogenous, climate-induced shocks are a major source of vulnerability, exacerbating macroeconomic instability, and making it harder for Malawi to break the cycle of vulnerability.** Maize accounts for roughly 90 percent of all land under cereal production and 54 percent of caloric intake by households. More frequent severe weather conditions have been leading to crop failure with downstream effects on food prices and agricultural outputs that keep households poor and can force two out of every five households into poverty.³ In 2015, the country experienced its worst floods in 50 years, followed by a drought in 2016, together resulting in annual estimated losses of US\$500 million across all sectors. Cyclone Idai in 2019 caused an estimated US\$220 million in physical damage to the country's capital stock. Accelerated by high population growth and environmental degradation, the negative impacts of weather shocks in Malawi are expected to worsen.
- 3. Malawi's 17.6⁴ million youthful, fast-growing, and primarily rural population poses a further challenge to poverty reduction and strains already weak service delivery systems.** Nearly 95 percent of the poor live in rural areas, with most locked in low productivity subsistence farming. The already dense population, expected to double by 2038, is exerting pressure on farm size and productivity, environmental sustainability, as well as limited public services. As workers are pushed out of agriculture, they tend to turn to low productivity informal service jobs. Urbanization has so far had little impact on structural transformation and has stagnated at about 15 percent since 1999 (WDI 2017), far below its neighbors.
- 4. There have been recent improvements in reducing extreme poverty and inequality, although geographic disparities remain.** Consumption growth of the bottom 40 percent of Malawians is now

¹ World Bank (2017) data base.

² World Bank (2016); Malawi Economic Monitor: Absorbing Shocks, Building Resilience. Macroeconomics and Fiscal Management Global Practice. Washington DC, World Bank.

³ Dang, Hai-Anh H.; Dabalen, Andrew L. 2017. *Is Poverty in Africa Mostly Chronic or Transient? Evidence from Synthetic Panel Data. Policy Research Working Paper*; No. 8033. World Bank, Washington, DC.

⁴ National Statistics Office (NSO) Malawi (2018). 2018 Population and Housing Census. Preliminary Report. December 2018.



increasing on average by 1.7 percent since 2010. The proportion of the population living in ultra poverty⁵ has reduced from 24.5 percent prior to FY 2010/11 to 20.1 percent in FY 2016/17. In contrast to rural areas where inequality has reduced since 2010, urban inequality has increased marginally over the years. In terms of regional disparities, inequality in the Northern and Central regions of Malawi has decreased, while in the Southern region it has increased. The Southern region also hosts the poorest five districts (Chitipa, Nsanje, Machinga, Mulanje and Phalombe) where poverty ranges from 66 to 83 percent.

5. **Despite recent improvements in child mortality, fertility, primary school enrollment and stunting levels, human capital development remains limited and improvements have disproportionately benefited the non-poor.** Between 2010 and 2015 infant and under-five mortality in Malawi declined to 42 and 63 per 1000 live births respectively compared to 56 and 83 for Sub-Saharan Africa (SSA) countries. The maternal mortality ratio (MMR) is 439 per 100,000 childbearing age women compared to 547 for SSA and the total fertility rate (TFR) is 4.4 compared to 4.9 for SSA. With 56 percent of the population below 19 years of age, 29 percent of girls being mothers by age 19, and a stunting rate of 37 percent of children under five, much more is needed to support Malawi's demographic transition. Malawi's 2017 Human Capital Index (HCI) of 0.41, means that a child born today will only be 41 percent as productive compared to a situation where the child had complete education and full health.

6. **At the macro level, Malawi's vulnerability to external and internal shocks has been reinforced by weak governance and institutions, contributing to cycles of economic crisis, corruption scandals and food insecurity.** Weak institutions and public financial management (PFM) in particular have tended to transmit recurring shocks into fiscal indiscipline, in turn exacerbating macroeconomic instability. Volatility in foreign aid receipts has also played a role in erratic fiscal management, with corruption scandals leading to the suspension of budget support three times since 2001. The 2013 "cashgate" scandal, in which some US\$50 million was lost through fraudulent transactions in the Integrated Financial Management Information System (IFMIS), resulted in the most recent downturn in Official Development Assistance (ODA) provided on budget, highlighting the 'implementation gap' between efforts to reform governance policies, rules and systems, and the ability to translate these into behavioral and institutional change.

7. **In recent years the Government of Malawi (GoM) has undertaken a program of reform to strengthen the control environment, information security and the timeliness of external audits.** The new reforms include the establishment of the Public Procurement and Disposal Authority (PPDA) and the PPDA Act 2017, and the Public Audit Act amendment 2018. The GoM also is implementing a new IFMIS software; and the national identification (ID) has been introduced in payment systems. With the support of the International Monetary Fund (IMF) bank reconciliations have improved for Malawi Government accounts. A 2018 Public Expenditure and Financial Accountability (PEFA) assessment noted improvements, including in relation to revenue administration, annual budget preparation and Parliamentary oversight. At the same time areas that deteriorated include outturn of composition of expenditure, budget documentation, intergovernmental fiscal relations and predictability in the availability of funds for commitment of expenditure.

8. **Malawi's relative macro-economic stability and growth since 2017 may present an opportunity to address long sought-after structural change that is needed to reduce poverty.** Following two years of

⁵ Ultra poverty is defined by the Malawi National Statistics Office as those whose consumption is beneath the minimum food consumption line.



depressed economic activity due to floods and drought, headline inflation has receded to single digit levels, and the Kwacha has been stable against the U.S. Dollar. Real GDP growth picked up to 4 percent in 2017, then 3.7 percent in 2018 and was projected to be 4.4 percent in 2019. Current analysis suggests that the impact of the Covid-19 pandemic could limit growth to 3.2 percent in 2020 under a low transmission scenario, with heaviest impact on the urban and peri-urban poor. Senior leaders recognize that of the many factors known to favorably impact on structural transformation, the quality of human capital is vitally important. Accordingly, high level policy reiterates the need to revitalize the delivery of core services and to invest in collateral assets and services (energy, economic and welfare-enhancing infrastructure, water and sanitation, transport) that help ease binding constraints on human capital development and thus supporting labor reallocations believed to be conducive to growth and social progress.⁶

B. Sectoral and Institutional Context

9. **Government systems for the delivery of basic services needed to develop human capital suffer from serious governance and institutional challenges.** The responsibility for basic service delivery increasingly resides in Malawi's thirty-five Local Authorities (LAs), yet they lack the resources and capacity needed to perform these functions. Fiscal constraints, poor planning processes and political expedience result in inefficient allocation of resources and insufficient oversight systems with consequences for service delivery and human development outcomes. Due to lack of donor confidence in government systems, the vast majority of development spending on service delivery is off budget support, which leads to fragmented and geographically uneven investments in health, education and other basic services.

10. **Health and education services suffer from very low ratios of medical workers/teachers to population even as personal emoluments dominate the budget, squeezing out other recurrent and development funding such as funding for basic supplies, equipment and much needed infrastructure.** Countrywide there is less than one health facility per 10,000 population (the target is 2 per 10,000), and less than half the target level of core health worker density; and these are inequitably distributed across and within districts.⁷ Primary education quality suffers from inequitable distribution of teachers; on average, the most understaffed school in a zone has a pupil-teacher ratio (PTR) five times that of the best-staffed school. While initial deployments are inequitable, District Education Managers are further pressured to authorize transfers away from remote locations where infrastructure and resources are limited. Vast unmet needs for capital spending (a national deficit of 36,000 primary schools alone) pose serious challenges for primary and secondary completion rates, especially for girls. Lack of access to improved water and sanitation facilities also affects school attendance, given that adolescent girls disproportionately collect water.

11. **Citizen perceptions of the government's handling of basic health services, educational needs and water and sanitation have been on a declining trend over the past decade according to Afrobarometer.** Indicators of government effectiveness, control of corruption, regulatory quality and

⁶ Sen K (2012). The Political Dynamics of Economic Growth, ESID Working Paper, No. 5. Manchester; Pritchett L and E Werker (2012). 'Developing the guts of a GUT (Grand Unified Theory): elite commitment and inclusive growth, ESID Working Paper no. 16. Manchester. And, for application of this to Malawi, see Said, J and K Singini (2014). 'The political economy determinants of economic growth in Malawi' ESID Working Paper no. 40. World Bank (2019), Malawi Strategic Country Diagnostic.

⁷ Government of Malawi Ministry of Health and Population, Harmonized Health Facility Assessment 2018/2019.



trust as measured by Worldwide Governance Indicators (WGI), Ibrahim Index of African Governments and Global Competitiveness Index (IIAG) have dropped from 2008 to 2017 (Table 1). The deterioration in these indicators is manifested in weak policy coordination and implementation of reforms, as well as limited transparency and accountability in the public sector. Indeed, vested interests in the public sector are prevalent, and have a disproportionate influence in policy making and public resource allocation. Coupled with weak capacity to implement reform programs, this has undermined effective service delivery.

Table 1: Malawi Government effectiveness, service delivery and trust indicators

Indicator	2008	2012	2018
Control of Corruption, WGI	36	38	25
Government effectiveness, WGI	36	38	22
Regulatory quality, WGI	33	27	25
Public trust in politicians, WEF GCI, out of 7**	2.98	2.67	1.9 (2017)
Judicial Independence, WEF GCI, out of 7	5.09	4.14	3.9
Institutions Pillar, WEF GCI, out of 7	4.17	3.72	3.36
Public Management Score Mo Ibrahim IIAG, out of 100	52.3	49.5	44.7 (2017)
Handling improving basic health services (% responding fairly/very well), Afrobarometer	73%	65%	40.6%*
Handling addressing educational needs (% responding fairly/very well), Afrobarometer	75%	65%	42.1%*
Handling providing water and sanitation services (% responding fairly/very well), Afrobarometer	55%	53%	40.1%*

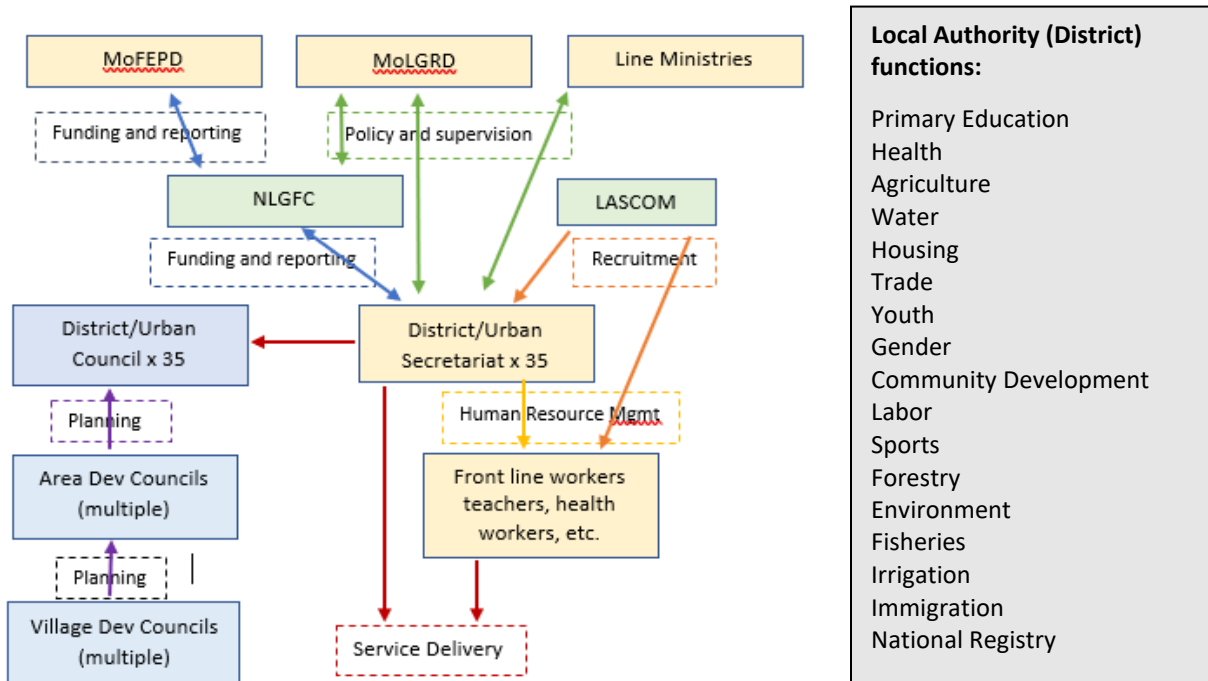
Worldwide Governance Indicators; Global Competitiveness Index; Ibrahim Index of African Governance; Afrobarometer

*latest survey round of Afrobarometer in Malawi was conducted between 2016-2018.

**Indicator was dropped in the World Economic Forum Global Competitiveness Index Report 2018.

12. **Decentralized service delivery was initiated as part of Malawi’s transition to multi-party democracy, with the aim of diffusing overly centralized power and bringing services closer to citizens through elected local councils.** Following the 1998 National Decentralization Policy (NDP) and Local Government Act (LGA), elections for thirty-five Local Councils - twenty-eight rural councils and seven urban councils – were first held in 2000. The political decision-making body of Local Councils is comprised of elected local councilors and Members of Parliament (under 2010 amendments) as voting members, and traditional authorities and five representatives of interest groups as *ex officio* non-voting members. The executive arm, the Council Secretariat, is led by a District Commissioner (rural councils) or a Chief Executive Officer (urban councils), and includes core functions of finance, administration and planning, and the heads of key sectors. At the sub-district level, Village Development Committees (VDCs) and Area Development Committees (ADCs) are meant to identify and consolidate community development priorities for the five-year District Development Plans (DDP). Local Councils are assigned responsibility for delivery of seventeen functions, while central ministries retain a policy and oversight role (Figure 1; see Annex 2 for a more detailed description of decentralization).

Figure 1: Decentralization Roles and Functions



13. **The status of policy reforms aimed at decentralized governance and service delivery was sluggish and fragmented for the first fifteen years.** The NDP has four key objectives: i) to devolve administrative and political authority to the district level; ii) to integrate government services at the district and lower levels into one administrative unit; iii) to assign functions and responsibilities amongst all levels of government; and iv) to promote popular participation in governance and development. However, local council elections did not take place in 2004 or 2009; 2010 amendments to the LGA were perceived as undermining ‘downward accountability’; and power contests and resistance from line ministries led to fragmentation and incoherence in the devolution of functions and resources.

14. **Since 2014 the decentralization agenda has gained momentum with a number of significant reforms.** This has been driven by the need to respond to widespread public discontent with the quality of services, while also addressing pressures from political fragmentation. From FY13-14 to FY15-16 total transfers to local governments nearly doubled – from MWK 17.5 billion to MWK 33.1 billion. Importantly, the District Development Fund (DDF) was introduced, for the first time providing discretionary development resources for councils to address local priorities. In 2017, the long-planned devolution of human resources shifted tens of thousands of personnel from central ministries to district administrations with recruitment managed by the Local Authority Service Commission (LASCOM). In 2018 the National Local Government Finance Committee (NLGFC), responsible for intergovernmental fiscal transfers, merged with the Local Development Fund (LDF), which managed mostly donor funded projects and institutional strengthening. The resulting body, NLGFC, is positioned to play a critical role in a more strategic and coherent approach to both fiscal decentralization and institutional performance of local governments.



15. **For this opportunity to translate into strengthened local services, the vicious circle of low trust – low investment – low accountability must be tackled.** While it is widely recognized in policy that decentralized service delivery can lead to greater efficiencies, equities and responsiveness, follow through by matching resources to functional responsibilities is impeded by concerns over poor local government capabilities. The result is continued incoherence in the system of intergovernmental fiscal and accountability relations which in turn weakens service delivery performance. Key challenges were identified using a problem-driven approach with multiple stakeholders and a forensic type analysis of subnational financing. These are summarized in this section, with a more detailed analysis in annex 2.⁸

16. **Local Government service delivery responsibilities are financed primarily by an inadequate system of intergovernmental fiscal transfer systems (IGFTS) including 18 sector transfers for heavily earmarked non-wage other recurrent transactions (ORT) and a fragmentation of politically driven development funds.** The system lacks a mechanism to correct vertical imbalances arising out of the decentralized expenditure and revenue assignments. The NDP mandates that at least 5 percent of net national revenues (NNR) should be transferred to local governments for development financing, but the meaning of development financing is disputed. Moreover, development transfers have yet to exceed 1.65 percent of NNR.⁹ The administration of the transfer system creates further difficulties, as cumbersome flow of funds processes and itinerant cash management priorities lead to delays, significant variance between approved budgets and actual receipts, and deviation from agreed formulae. As a consequence, financing bears little relationship to expenditure needs and differential costs of delivery. While locally raised revenues are a meaningful source of funding for the urban councils that collect property tax, the 28 district councils have a very low revenue base and significant leakage. The Ministry of Local Government and Rural Development (MoLGRD) and NLGFC are initiating a comprehensive review of the IGFTS toward a fiscal decentralization strategy that addresses these shortcomings.

17. **A lack of qualified and capable personnel for key functions is also a major constraint to effective service delivery.** A 2015 capacity assessment of local councils carried out by the Local Government Accountability Project (LGAP) found an overall vacancy rate of 71 percent against the Establishment Warrants. While this may not account for staff competencies that exist but are outside of the authorized positions, a 2019 staffing review identified an overall vacancy rate of 56 percent against a defined set of six core governance functions. This has undermined the most basic functions of accounting, managing civil works and administration. Wage bill constraints, insufficient recruitment capacity and inability to enforce redeployments from the center and to remote areas and retain staff with special skills have contributed to the problem. Institutional and capacity building of councils has been ad hoc and undermined by the frequent rotation of staff.

18. **Financial accountability and controls are weak, reflecting capacity deficits as well as an ineffective system of oversight and intergovernmental accountability.** Audit reports document repeated

⁸ This analysis has been informed by a sub-national public expenditure review undertaken in 2019 with a World Bank and GoM team; NAO audit reports of local councils; a PFM assessment of local councils; field visits to several district councils and numerous stakeholder consultations.

⁹ For this purpose, development transfers includes: DDF; Infrastructure Development Fund (IDF - discretionary resources for the urban councils); Constituency Development Fund (CDF); and ad hoc special purpose transfers for boreholes and community development.



failures to carry out bank reconciliations or large amounts of unreconciled items or “discrepancies”. Lack of supporting documentation for transactions, procurement irregularities, mis-postings, unauthorized virements and cash payments are also frequently cited. Local government is not an exception to the problem of impunity affecting the public service – it is widely recognized that mismanagement is rarely sanctioned.

19. **Planning processes are fragmented with poor community participation and democratic accountability.** DDPs vary in quality and state of preparation, and often are disjointed from sector development plans and from annual budgeting processes. VDC) and ADCs are meant to provide a representative mechanism for the identification of community development priorities and a means of monitoring and holding councils accountable. In reality, to the extent these priorities are identified, the committees report upwards, but little feedback is passed downwards. This disjuncture has a particular impact in promoting gender-informed developed since ward councilors are overwhelmingly male. Literature shows that women’s representation in community leadership increases collective action capacity to provide public goods, and boosts community-level agricultural productivity and welfare.¹⁰

20. **The above challenges stem from capacity gaps and technical deficits, but more fundamentally they reflect a breakdown in key accountability relationships.** The effect of the parlous state of the IGFTS – the mechanism by which the center is meant to realize policy priorities for local service delivery – is to disable the accountability relationship between local government and citizens. At the same time, it enables poor financial and resource management practices. Council officials point to a slew of constraints that stem from the central government and are beyond their control – insufficient staff, information and communications technology (ICT) problems affecting proper use of the IFMIS, and inadequate policy guidance. Untimely and unpredictable fiscal transfers, particularly the DDF, are a serious impediment to effective investment planning and implementation. The amount of DDF in the approved budget has consistently been cut significantly at mid-year (by 43 percent in 2015/16; 47 percent in 2017/18; 60 percent in 2018/19). Political economy factors surely contribute to patterns of mismanagement. But to a certain extent, deviation from required practices is in effect a coping strategy, bending the rules in order to meet pressing needs, such as paying contractors on time, supplying health facilities, responding to seasonal demands in agriculture and meeting the needs of traditional authorities.

21. **The experience of decentralization across the continent is that it is a deeply politically contested process, but that it is possible to incentivize the performance of elected and administrative officials at strategic points along the service delivery results chain from central to local levels.** Interventions that strengthen key accountability relations can multiply the returns on investments in three ways: first, by cost-effectively delivering assets and services crucial to human capital development; second, by cycles of positive return from incremental improvements in the efficiency of subnational authorities, including the ways they and citizens engage; and third, by leveraging this improved coproduction performance into greater outlays by central authorities, and by donors more readily adopting national systems.

C. Relevance to Higher Level Objectives

¹⁰ World Bank (2018). Malawi Systematic Country Diagnostic.



22. **Malawi's national development strategies have consistently identified decentralization as a key vehicle to strengthen local service delivery.** The project responds to MGDS III, 2017 – 2022, which identifies five priority service delivery areas¹¹ and calls for full devolution to allow LAs to play an effective role in delivering on these priorities. This reiterates the objectives and commitments laid out in the 1998 NDP and LGA, which has further been incorporated in multiple sector strategies since then, including the National Education Sector Plan (NESP, 2013-2020) and the Health Sector Strategic Plan II (HSSP II, 2017–2020). The project is timely to support a number of recent initiatives to accelerate implementation of these objectives in ways that address the deficiencies outlined above, including devolution of human resources, introduction of a discretionary DDF, a drive to fill vacancies for priority positions, and a performance assessment process to incentivize improved institutional performance. By strengthening and building confidence in LA capability and Government financing systems, the project will serve as a backbone for advancing sector aims through country systems.

23. **The proposed operation is closely aligned with the World Bank Group (WBG) strategic development priorities for Malawi – including the extended Country Assistance Strategy (CAS, FY13-FY16)¹² and the Country Partnership Framework (CPF, FY21-FY25) under preparation.** The project contributes to the continued delivery of Theme 3 of the CAS on *Mainstreaming Governance for Enhanced Development Effectiveness*, calling for the WBG to support cross-cutting efforts to strengthen both supply-side and demand-side institutions, with an emphasis on enhanced governance across the portfolio. The project design responds to lessons from the Performance and Learning Review (PLR) and Systematic Country Diagnostic (SCD)¹³, which highlight the value of a results-driven approach to governance reform across levels of government which can help alleviate constraints to service delivery, while moving towards a social contract responsive to citizens. Towards these ends, the project aims to complement sector projects in education, water, early childhood development, health and social protection under the new CPF by focusing on the institutions and systems that are responsible for these services and by reinforcing sector results through institutional incentives.

24. **Further, the project will support Malawi's prioritization of investments in human capital and is consistent with the WBG's Human Capital Project (HCP), of which the Malawi Government is an early adopter.** Over the last two decades, Malawi has made significant progress on some core human capital indicators such as maternal and child mortality and primary school improvement rates -- largely attributed to donor interventions and the free primary school initiative. Despite these achievements, significant limitations remain in the coverage, access, and quality of public services. Many of these challenges are exacerbated by underlying fiscal and governance constraints such as the effects of low ratios of health workers and teachers being worsened by inequitable distribution, lack of infrastructure and poor links between pay and performance. The project will aim to support key areas of governance in the service delivery results chain.

¹¹ The MGDS III identifies five key priority areas: (1) agriculture, water development and climate change management; (2) education and skills development; (3) transport and ICT infrastructure; (4) energy, industry and tourism development; (5) health and population.

¹² World Bank. 2012. Malawi - Country Assistance Strategy for the period FY13 - FY16. Washington, DC: World Bank. The CAS was extended through FY17 by the Performance and Learning Review of the Country Assistance Strategy, dated March 25, 2015, Report No. 95178-MW.

¹³ World Bank. 2018. Malawi – Systematic Country Diagnostic: Breaking the Cycle of Low Growth and Slow Poverty Reduction. Washington, DC: World Bank.



II. PROJECT DESCRIPTION

A. Project Development Objective

PDO Statement

To strengthen Local Authorities' institutional performance, responsiveness to citizens, and management of resources for service delivery.

25. The PDO of the project focuses on the institutional strengthening of LAs to improve management of resources for responsive service delivery. The higher-level goals which the achievement of the PDO will serve are improved service delivery in terms of capital investments and facility level management in rural areas. This is where most of the poor reside and face significant challenges in equitably accessing basic services. By strengthening confidence in local institutions, the project will further support a path to crowd in donor resources toward a government-led national service delivery system.

PDO Level Indicators

Strengthened institutional performance: PDO Indicators 1 and 2 measure improvements in LA institutional performance for service delivery using scores on the performance assessment. Indicator 1 measures improvements in relation to basic fiduciary functions with reference to the minimum access conditions and triggers that determine eligibility for the Performance-based Grant (PBG). Indicator 2 measures improvements in institutional performance in relation to the three clusters of performance assessed by the performance assessment – delivery of quality investments that respond to community priorities; efficient and accountable management of resources; effective management of frontline service delivery staff.

PDO Indicator 1: Local Authorities that are eligible for the Performance Based Grant (number)

PDO Indicator 2: Local Authorities that increase their performance assessment score by at least 5 points (number)

Strengthened management of resources: PDO Indicator three measures improvements in LA management of financial and human resources in terms of their conversion into development assets in accordance with annual plans.

PDO Indicator 3: Local Authorities that complete 80 percent of the capital investment projects in their Annual Investment Plans (AIP) (number)

Strengthened responsiveness to citizens: PDO Indicator four measures improvements in LA responsive to citizens as measured by citizen feedback on 4 aspects of the AIP: opportunity for participation; efficiency of implementation; responsiveness to citizen needs; transparency of process.

PDO Indicator 4: Increase in citizen satisfaction (disaggregated by sex) with preparation and implementation of AIPs based on periodic beneficiary feedback survey (percentage)

B. Project Components



26. **The project comprises a set of interlocking components to address governance bottlenecks to basic service delivery at national and local levels.** At the local level, the project uses a results-based approach to strengthen the governance of public resources to improve service delivery in Malawi's twenty-eight district LAs.¹⁴ It is designed to incentivize effective and accountable institutional performance of LAs with a focus on three core functions: (1) delivery of quality development projects that are responsive to local needs; (2) accountable management of public financial resources; and (3) effective management of frontline service delivery staff. This will be achieved through the introduction of a PBG aligned with the intergovernmental fiscal transfers which will substantially increase funding for development projects identified in DDPs, commensurate with each LA's level of capability as determined through an annual performance assessment. The PBG will operate to the extent possible under strengthened Government standards, guidelines and manuals so as to reinforce country systems. The PBG will supplement and leverage the government funded DDF, and it is intended that the two will be merged and fully aligned mid-way through the project. Expanding both the quantity and quality of development investment by LAs will positively impact the services received by the rural population. The improved performance of LAs will also build confidence in their ability to manage increasing resources in line with their devolved functions, laying a foundation for a coherent framework for government service delivery systems and for crowding in and delivering donor funding through country systems.

27. **Recognizing the critical policy and operational roles of central government agencies in enabling improved governance at the district level, the project will also strengthen their capacities to perform these roles.** The project will support four such areas. First, support will be provided to address deficiencies in the *fiscal decentralization framework* that hinder LA performance, including the predictability, timeliness, transparency and equity of the transfers. The project will help revamp the intergovernmental fiscal transfer system into a more coherent and effective instrument of policy. Second, the project will strengthen the *public finance accountability loop* by supporting the National Audit Office (NAO) to undertake timely audits of LA financial statements. Third, the project will address *functional human resource gaps* in LAs by supporting the LASCOS to undertake timely and strategic promotion and recruitment of staff for a set of agreed critical functions in LAs. Fourth, the project will support relevant Ministries, Departments and Agencies (MDAs) to deliver on their *policy, guidance and capacity building* roles with regard to LAs through a robust approach to targeted performance improvement, including strengthening the policy and operational framework and delivering capacity support to LAs.

28. **Gender sensitive citizen engagement will be promoted through all project components.** At district level, publicizing the annual results of the performance assessment, the annual investment plan, and reporting on its implementation will provide an objective basis for productive contests involving citizens and elected and administrative district officials. Compliance with strengthened government standards and guidelines for citizen participation and gender responsiveness at key aspects of the investment project cycle – the provision of actionable information; selection and appraisal of projects for the annual investment plan, including climate screenings and resiliency measures; awarding contracts; monitoring their implementation – will feature as performance measures (PM) that will be scrutinized through the LA performance assessment and will thus impact directly on the size of the PBG available to each LA. The project will further support a range of mechanisms for promoting information and feedback flows, including use of community radio, mobile phone messaging and an interactive web-based platform

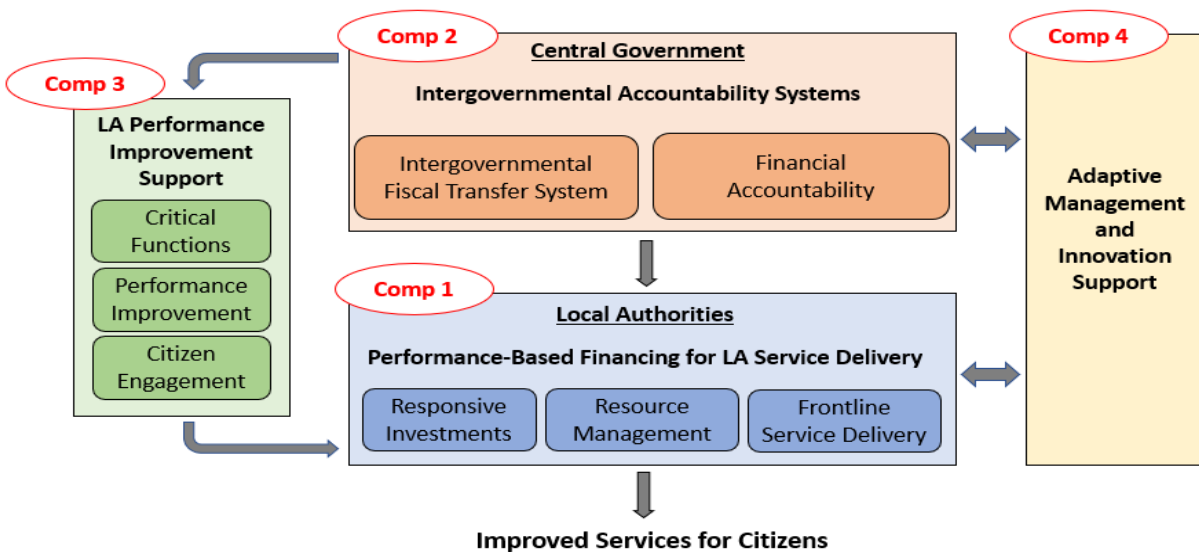
¹⁴ This PAD uses the term 'Local Authorities' to refer to the twenty-eight district local authorities, excluding the seven urban local authorities.



for mapping and monitoring LA AIPs. Social accountability tools, including score cards, public procurement and expenditure tracking will be tested and where proven effective and potentially sustainable, their institutionalization will be promoted. The project will also participate in a pilot grievance redress mechanism (GRM) to be operated by a third party with the aim of serving as a national GRM. These aspects will be overseen by a joint committee of government officials and civil society representatives.

29. **The project is comprised of four components:** Component 1: Performance-Based Financing for LA Service Delivery; Component 2: Strengthening intergovernmental Accountability Systems; Component 3: LA Performance Improvement Support; and Component 4: Adaptive Management and Innovation Support (Figure 2).

Figure 2: Project Design



Component 1: Performance-Based Financing for Service Delivery (US\$73.2 million equivalent)

30. **This component aims to substantially enhance predictable development financing for LAs in a manner that incentivizes sustained improvements in efficiency, equity and accountability in the execution by LAs of their service delivery responsibilities.** It will do so through the introduction of a performance-based grant (PBG) accessible to LAs that meet minimum access conditions demonstrating basic safeguards related to proper use of the grant. The grant will provide broadly discretionary resources for LAs to finance priority development investments that are resilient and enhance public services, as selected through a participatory process. The PBG will be allocated to LAs so as to reflect two key principles: first, the formula will ensure that resources are allocated in a manner that reflects relative needs and costs of delivering services; second, this ‘basic allocation’ will be augmented by a ‘performance allocation’ determined in accordance with the results of an annual performance assessment, so as to create significant incentives for improved institutional performance. Those LAs that do not qualify for the PBG will be provided with targeted capacity support (see Component 3) with the objective of becoming eligible in subsequent years. Sustainability will be promoted by integrating the PBG and the Government-funded DDF in a revamped inter-governmental fiscal transfer system (see Component 2). Thus, in addition to financing much needed small-scale infrastructure across LAs – including school blocks, teacher housing, health clinics and water, sanitation and hygiene (WASH) – this component will, in conjunction with



Components 2 and 3, strengthen the overall financing and performance of the national system for basic service delivery needed to build human capital.

31. **Under this component the project will finance two sets of activities:** (1) Use of the PBG (approximately US\$70 million) for climate-informed capital investment projects identified in approved LA AIPs and in accordance with the agreed investment menu, and allowable servicing costs; (2) Conduct of the annual performance assessment and related activities (approximately US\$3.2 million). This will include; printing and revisions of the performance assessment manual; contracting the independent firm to carry out the performance assessment; quality assurance of the performance assessment including spot checks; training and workshops for the performance assessment task force to oversee and administer the assessment; and dissemination of results.

Sub-component 1.1: Performance-Based Grant (US\$70 million equivalent)

32. **The PBG will be available to the twenty-eight District LAs, provided they meet eligibility conditions.** The Government intends that the PBG will be nation-wide in coverage, that is, available to all 35 LAs, urban and rural. Due to limited resources as well as significant differences in the service delivery responsibilities and modes of financing between the 28 district LAs and the seven urban LAs,¹⁵ the project will not include the latter at the outset.

33. **Allocation Formula.** To ensure that LAs receive allocations that simultaneously reflect their relative service delivery burden and incentivize performance, the allocation formula for the PBG has two elements. The first element is allocated through application of a basic equitable needs-based formula (see Table 2), which has been defined in light of: a) the quality of existing national data sources; b) the need for an affinity with the existing formula for the DDF; and c) the need for simplicity to support transparency. The second element is allocated based on performance, as determined through the performance assessment process. In the first PBG round, the weighting will be 60 percent needs-based, 40 percent performance based. Each round it will shift gradually toward a higher performance weighting (Table 3).

Table 2: Factors and weights for the basic need-based allocation formula

Factor	Weight	Rationale
Population	40%	A significant portion of the grant allocated according to population as the service delivery responsibilities / cost of services of a LA is closely related to the population it is to serve.
Poverty	40%	Ensure that differential levels of endowment across LAs are acknowledged, consistent with government policy commitments to equity of outcomes (30 percent poverty head count and 10 percent ultra- poor persons).
Land Area	10%	The relative cost of services on a unit and recurrent basis are approximate to LAs land areas
Equal (fixed) Share	10%	Very small LAs need a minimum allocation to make meaningful investments.

¹⁵ The seven urban LAs include four cities, two municipalities and one town. While each category is different, urban LA have comparatively more buoyant own sources of revenue and bear responsibility for more capital-intensive municipal services and assets. The municipalities and town rely on neighboring district LAs for some service staff (health and education). In recognition of these differences, the government provides DDF for rural LAs, and an Infrastructure Development Grant for urban areas.



Table 3: Indicative weighting of the needs-based and performance dimensions of the PBG¹⁶

PBG round	Needs-Based element (percent)	Performance element (percent)
1	60	40
2	55	45
3	50	50
4	45	55

34. **Grant size.** The average size of the PBG will build up to approximately US\$1.5 per capita. This has been calculated to ensure a meaningful contribution to LA service delivery responsibilities, taking into account: the NDP (which provides that Government will make available at least 5 percent of net national revenues to be used for the development of Districts); other development funding channels (Government, own source revenue and donor funds); practice in countries similar to Malawi; and the budget envelope available to the project GESD over a five year implementation period. This will be a substantial increase over the DDF, a grant with comparable features to the PBG in terms of the degree of discretion it provides to councils, and the permissible objects of spending. Combining the DDF with the two other fiscal transfers for development, the Constituency Development Fund (allocated per each Member of Parliament) and the Boreholes Fund (a transfer intended to finance 4 boreholes per ward), the per capita value of development transfers amounted to US\$0.81 in 2017 and US\$0.62 in 2018. While the DDF has been volatile and unpredictable in previous years, government has committed to stabilizing it to an amount no less than MWK 3.2 billion per year (approx. US\$4.4 million), as per the FY 2019-2020 budget, adjusted by the Consumer Price Index.

35. **Annual PBG pool.** Each year the pool of PBG funds will increase toward the goal of US\$1.7 per capita across all LAs (Table 4). This gradual approach presumes that: (1) the number of eligible LAs will increase over time; (2) LA capacity to manage funds effectively will increase over time; and (3) incremental increases in the per capita value of PBG allocations can enhance the fiscal incentives for continuous performance improvement. The annual pool therefore reflects estimates of the number of LAs that will qualify for the PBG and the average performance scores, an incrementally increasing indicative per capita amount, and the resources available through the GESD project. Table 4 sets out indicative figures for the annual PBG pool. Each year the amount to be disbursed will be determined following the annual performance assessment results to ensure that LA allocations remain within the target per capita ceiling.

Table 4: Indicative annual PBG disbursements, DDF and per capita amounts

	FY 2020/21	FY 2021/22	FY 2022/23	FY 2023/24	FY 2024/25	Total US\$ million
Population of 28 LAs	15.30	15.74	16.20	16.67	17.15	
DDF (minimum)	US\$4.4 million	US\$4.6 million	US\$4.8 million	US\$5 million	US\$5.3 million	US\$24.1 million

¹⁶ This means that in the first round 60 percent of the total annual PBG pool will be allocated to qualifying LAs using the needs-based formula only; the remaining 40 percent will be distributed to the same LAs using the needs-based formula as weighted by their performance assessment score (0-100). The system ensures that all of the funds are allocated each year (no balances) and is thus administratively feasible, given MoFEPD obligations for budget and expenditure control.



	FY 2020/21	FY 2021/22	FY 2022/23	FY 2023/24	FY 2024/25	Total US\$ million
PBG pool	--	US\$10 million	US\$15 million	US\$20 million	US\$25 million	US\$70 million
Target per capita PBG ceiling*		US\$0.65	US\$0.93	US\$1.2	US\$1.46	
Indicative per capita funding (PBG + DDF)	US\$0.28	US\$0.95	US\$1.22	US\$1.5	US\$1.76	

Assumptions: i) annual population growth at 2.9 percent; ii) DDF increase of 5 percent per year (as per MTEF)

* Assumes all 28 LAs are eligible for the PBG

36. **Utilization of the grant.** The recipient LAs will use the PBG funds to supplement the DDF to finance development projects identified in their DDPs. The planning, budgeting and investment management processes will be in accordance with the Public Finance Management Act (2003) as well as official guidelines and circulars issued by the competent government authorities. Several of these will be updated in the lead up to the first round of PBG transfers. Compliance with the guidelines will be reinforced by the access conditions and PMs that determine eligibility for and allocation of the grant. The investment menu (i.e., the eligible objects of grant expenditure) is closely aligned with the DDF and provides LAs with discretion in the selection of projects identified in the five-year DDP for inclusion in the AIP, with modest additional limits on the scope of discretion so as to build confidence with stakeholders (MDAs, Development Partners) that resources will be directed to poverty and human capital development results.

37. Table 5 defines the eligible expenditures on a sectoral basis and examples of what eligible investments could include. It also details a negative list of proscribed expenditures. The PBG performance measures will incentivize LAs to invest in the completion and rehabilitation and upgrading of existing public assets – thus enhancing the economic multiplier of PBG investments. Up to eight percent of the total value of the PBG will be reserved for ‘investment servicing costs’, to finance technical services (design, social verification, feasibility studies) and technical supervision and monitoring, including via the participation of civil society at critical points in the investment cycle (see Component 3, below). The ‘negative list’ proscribes particular investments – including land acquisition, vehicle purchase (where these are permissible under the relevant sector ORT transfers), investments whose principle purpose is to generate revenue, and excludable private goods.

Table 5: PBG Eligible Investments and Negative List

Sector	Eligible investments include:
Education	New Primary Schools, Teacher Development Centers, classroom construction and rehabilitation, furniture (desks, chairs), teachers housing
Health	Rehabilitation and construction of health units, medical equipment, furniture, beds
Water and Sanitation	Gravity fed water supply, shallow wells, springs, public latrines, sewerage and waste dumps.
Agriculture and Environment	Agricultural demonstration projects. Community nurseries inputs (watering cans, seeds, tools, tubes). Communal headworks, mechanical and solar/power for small scale irrigation
Transport	Construction, rehabilitation and grading of undesignated roads, bridges, community roads, culverts, footbridges, including associated drainage



Public service	Bus shelters, village markets, police posts
Negative List	
Security Services	
Micro-credit and savings	
Land purchase and compensation	
School bursaries and scholarships	
Transport, purchase and maintenance of vehicles	
Training, study tour, 'capacity building'	
Private compensation for disaster damage	
Medical supplies and drugs	
Administrative offices, associated furniture and supplies	

Sub-component 1.2: Local Authority Performance Assessment (US\$3.2 million)

38. **Eligibility for the PBG and the amount of the performance element will be determined by an annual Local Authority performance assessment.** The performance assessment objectives are to: i) ensure that before LAs access the PBG they demonstrate basic capabilities and safeguards; ii) provide an official set of objectively verifiable indicators (OVI) and means of verification (MoV) for scoring LA performance; iii) identify performance gaps to inform interventions targeting both LAs as well as relevant MDAs (which will be supported through Components 2 and 3); and iv) provide a consistent and predictable flow of empirically based knowledge to inform dialogue around intergovernmental relations, service delivery results and monitor the performance of donor supported programs.

39. **Eligibility for the PBG.** While all 28 LAs will be entitled to access the PBG, on an annual basis eligibility to do so will be determined through two sets of prior conditions in the performance assessment. The first, called Minimum Access Conditions (MACs), are assessed against LA performance in the previous fiscal year on two basic indicators (submission of annual financial statements; 100 percent compliance with the investment menu). The second, called Triggers, are designed to ensure that LAs have basic fiduciary safeguards in place to manage the coming fiscal year's grant. Each LA must meet all MACs and Triggers before any grant transfer is made to the LA.

40. **Performance dimension of the PBG.** LAs that meet the MACs and Triggers will be eligible for the needs-based portion of the grant (60 percent in the first round). The remaining 40 percent will be determined based on the third element of the performance assessment, which comprises a series of PMs. LAs will be scored against three clusters of PMs, designed to incentivize improvements on: i) delivery of quality investments that respond to community priorities; ii) efficient and accountable management of resources; iii) effective management of front-line service delivery staff (Table 6).

<p>Box 1: All performance assessment conditions and measures conform to the following principles:</p> <ul style="list-style-type: none"> • Support compliance with existing regulations (laws, official guidelines, instructions) • Address a key blockage on LA performance and service delivery • Objectively verifiable and measurable without ambiguity • Realistically under the control of and attributable to actions by the LA • Potentially able to be improved upon within the annual inter-assessment period • Prioritized and limited in number to maximize the incentive effect.
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Table 6: Overview of the performance assessment eligibility and PMs

	Element	Purpose	Indicators
A	MACs	To ensure that LAs have basic capacity to manage and account for the grant as a condition of access. Assessment of previous FY takes place between November and January.	<ol style="list-style-type: none"> 1. The LA has prepared and submitted annual financial statements (end of year Final Accounts) for the previous FY to NLGFC following the PFM Act, and Accountant General circulars. 2. The LA has spent DDF and PBG¹⁷ on eligible expenditures in the previous FY – 100 percent compliance to the investment menu.
B	Triggers	To ensure that LAs have basic fiduciary safeguards for expenditure of the grant as a condition of release of the funds. Assessment primarily of preparation for the coming FY takes place in June.	<ol style="list-style-type: none"> 1. The LA has an AIP for the coming FY approved by the full council and NLGFC. 2. The LA has Annual Budget Estimates for the coming FY approved by the full council and NLGFC. 3. The LA has developed a consolidated annual procurement and assets disposal plan for the coming FY in line with the Public Procurement Regulations and guidelines. 4. The audit opinion of LA Financial Statement for the previous FY is not adverse or disclaimer. 5. The LA has a qualified procurement officer on staff.
C	PMs	To assess LA performance for purposes of calculating the performance element of their share of the PBG. Assessment of previous FY takes place between November and January.	<p>Three clusters of performance (each with a number of PMs) will be assessed:</p> <ol style="list-style-type: none"> 1. Delivery of quality investments that respond to community priorities <ul style="list-style-type: none"> - Development planning and budgeting - Human resource management - Procurement management - Contract management and project implementation - Access to information 2. Efficient and accountable management of resources <ul style="list-style-type: none"> - Mobilization of locally generated revenue - Budget execution - Financial management/accounting - Physical progress reporting and monitoring and evaluation (M&E) - Internal Audits - External Audits 3. Effective management of frontline service delivery staff <ul style="list-style-type: none"> - Data systems and payroll for teachers, health and agriculture workers - Teachers physically present in schools where they are deployed

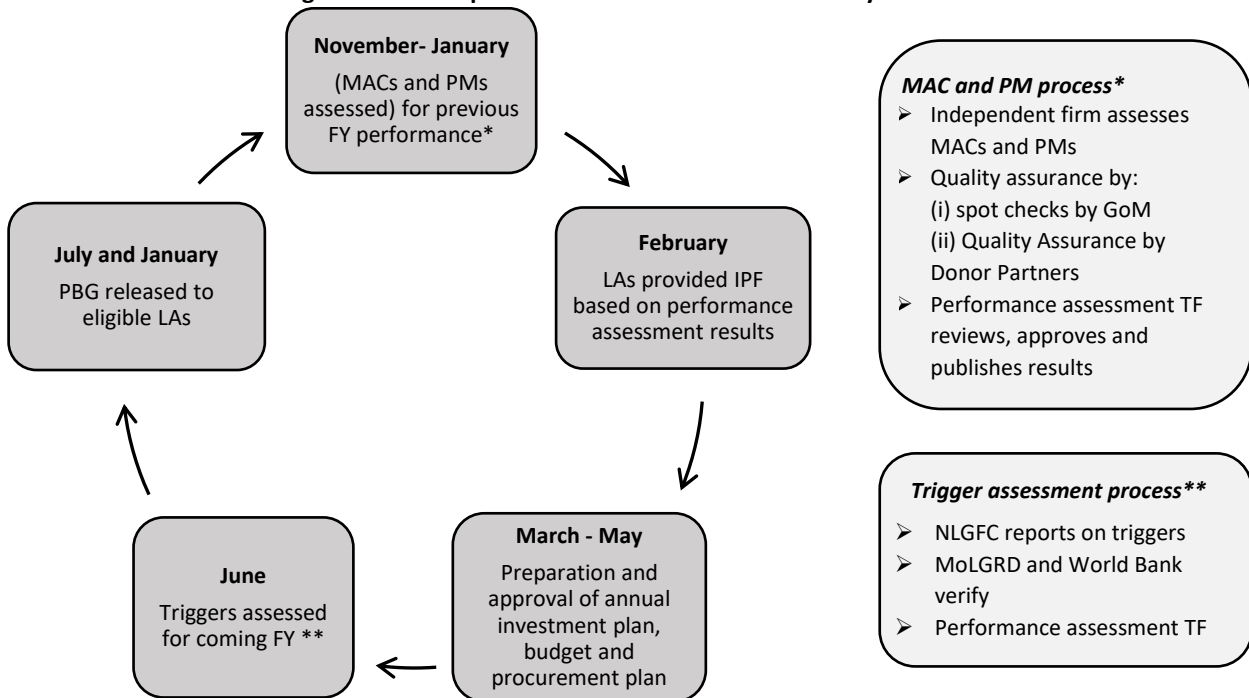
41. **The performance assessment will be carried out annually in accordance with the government budget cycle through a process that ensures robust multi-year credibility and objectivity (Figure 3).** The executive responsibilities under the performance assessment Framework will rest with the performance assessment Task Force under the leadership of the MoLGRD, which has the mandate for monitoring the performance of LAs. Conduct of the performance assessment, in respect of primary source information

¹⁷ Before the PBG first cycle release, MAC 1 will only focus on spending the DDF on eligible expenditures in the previous FY.



pertaining to MACs and PMs, will be via a contracted independent team (comprising expertise in governance, planning and execution, public finance and service delivery), with secondary source information provided by the appropriate MDAs. The independent team will compile performance assessment reports for each LA using a web-based tool/system with a centralized database that enables real-time monitoring of quality and milestones and rapid generation of LA reports, while maximizing transparency by enabling online access by LAs, Task Force members and the public. The contracting and management of independent performance assessment teams will be MoLGRD’s responsibility, consistent with its inspection mandate, as will be the responsibility to engage Quality Assurance teams, so as to verify the diligence and objectivity of assessments. Independent quality assurance will be augmented by experts engaged by Development Partners – initially the World Bank.

Figure 3: Annual performance assessment and PBG cycle



42. **Sustainability, transparency and accountability.** As one of several measures to ensure long term sustainability of the anticipated governance and service delivery results, effort has been made from the outset to embed the key norms and design elements of the PBG in GoM systems and procedures. The Government is committed to stabilize the DDF as the primary intergovernmental fiscal transfer for funding development expenditures as prioritized through the LA planning and budgeting process. This commitment, reinforced by a disbursement condition, has three aspects: i) in the near term, the Government has committed to maintaining the DDF at its current level (MWK 3.18 billion per annum) at a minimum (adjusted for population growth and inflation), and while acknowledging the impact of unforeseen fiscal shocks, it will aim to maintain an equivalence between approved budgets and actual receipts by LAs, and to ensure timely within-year release of DDF tranches to LAs. To improve allocative efficiency, equity and transparency, the Government has further reiterated its intention to renovate and ensure the consistent application of the DDF allocation formula and in the near term align it with the PBG formula. Over the medium term, the Government will, under Component 2 take measures to update the 1998 Decentralization Policy with the aim of, *inter alia*, reducing the vertical (national-local government)



fiscal imbalance and renovate the existing system of intergovernmental grants. The future of the DDF, and its relationship with the GESD-funded PBG, will be determined in that context.

43. At the same time, the design addresses efficiency, effectiveness and fiduciary concerns to build confidence amongst donor partners so that over time they can align and channel service delivery ODA through this modality. It is anticipated that confidence in this procedure will enable it to inform a wider range of inter-governmental fiscal transfers (including ORT) and help to harmonize Development Partner support to local governance and service delivery.

Component 2: Strengthening Intergovernmental Accountability Systems (US\$3.8 million equivalent)

44. **This component will support two central government functions that are critical to strengthening intergovernmental accountability relations.** The PBG introduced under Component 1 will help stabilize and augment the flow of development financing to LAs, thereby enabling more predictable and transparent planning and implementation of climate-informed and resilient investment projects. Sub-component 2.1 will consolidate and expand on these gains by revamping the intergovernmental fiscal transfer system into a coherent and effective instrument that is able: i) to support implementation of national policy on service delivery standards and responsibilities of local government, and (ii) to enable local governments to hold national agencies to account in respect of their policy, fiscal, and administrative obligations to subnational authorities. Sub-component 2.2 will strengthen the system of accountability for local government public resource management by supporting the NAO to conduct quality and timely audits of LA annual financial statements.

Sub-component 2.1: Strengthened Service Delivery Financing Through Fiscal Decentralization (US\$3 million equivalent)

45. **This sub-component will strengthen mutual accountability of central government and local governments around service delivery financing by strengthening transparency and implementation of the existing IGFTS, and by supporting development of a fiscal decentralization strategy, including own source revenue, to guide renovation of the IGFTS.** Malawi's Decentralization Policy dates to 1998 but this has not proven to be an effective policy framework through which to discipline the proliferation of earmarked sector and development grants nor to mollify the disruptive effects of a volatile cash management-based intergovernmental financing system. As a consequence, the current IGFTS has considerable shortcomings which include: (i) the lack of norms to establish, estimate or correct vertical imbalance; (ii) transfer formulas which are poorly understood, lacking transparency, and not predictive of actual transfers; (iii) wide variation in the equalization effects across transfers; and (iv) the existence of multiple, fragmented and earmarked transfers. These shortcomings result in allocative inefficiencies, inequities and cash flow problems that hamper service delivery at the facility level and undermine local government effectiveness and accountability.

46. **Interventions will support GoM efforts to improve performance and transparency of the existing IGFTS, while laying the ground for a more coherent fiscal decentralization strategy to underpin a more equitable and effective financing framework for service delivery.** Both prongs will be brought together through an Annual Forum on fiscal decentralization in which an Annual Report on the performance of the IGFTS will be discussed together with analysis and recommendations on select aspects



of fiscal decentralization (including reports by the NLGFC, the performance assessment Task Force and, periodically, reflections on the harmonization and alignment of donor assisted projects). The Forum will serve as a space for stakeholder engagement, guidance on policy direction, and agenda setting for executive and parliamentary decision-making. Key intervention areas in this respect include the following:

- i. **Strengthening NLGFC to administer and support the existing system of intergovernmental fiscal relations.** This includes: i) applying the agreed formulae to allocate each of the fiscal transfers across local governments; ii) reviewing the relevance and effectiveness of grants and recommending changes to their structure and formulae; (iii) reporting on the annual performance of the IGFTS in terms of budget and expenditure; (iv) supporting local revenue strategies; and (v) coordinating donor funding for local development and service delivery. Support will include: technical assistance; skills enhancement; and development of digital systems to improve efficiency and transparency in administration of and reporting on the IGFTS.
- ii. **Analytical work and policy dialogue in support of medium-term fiscal decentralization strategy and outcomes.** Areas of support include: (i) clarification of service delivery responsibilities for central and local governments, and addressing vertical imbalances, (ii) reform of the grant system to avoid fragmentation and increase the space to respond to locally identified priorities; (iii) practical measures to improve the adequacy, equity, timeliness and reliability of fiscal transfers; (iv) improvements in local government revenue policies, including the assignment of taxes and other revenue sources and use of technology to minimize leakages; (v) reform of the institutional, coordination and review and reporting mechanism associated with intergovernmental fiscal relations; and (vi) mechanisms to enable emergency financing in response to climate-related and other disasters. Support will include strengthening relevant MDAs through: technical assistance; cross-country learning; and stakeholder consultations.

Sub-component 2.2: Strengthened Accountability of Local Authorities Through External Audit (US\$0.8 equivalent)

47. **This sub-component will support the NAO to conduct timely financial audits of local government financial statements.** A critical constraint on intergovernmental accountability is the absence of timely and effective linkages between the production of end of year financial reports by LAs, the conduct of external audits by the NAO, and the deliberative and oversight responsibilities mandated to the Public Accounts Committee and Parliament. Several features of the PBG (the MAC and PMs) target constraints at the LA level (e.g., timely production of auditable annual reports, responsiveness to audit and management queries by the NAO).

48. **This sub-component addresses the part of the accountability loop related to the NAO's statutory mandate to conduct annual financial audits of LAs for submission to parliament within six months of the end of the fiscal year.** While capacity constraints prevented timely annual audits of LAs for some years, the NAO was able to clear the backlog by 2018 with support from development partners. Still, financial audits have been conducted only for those LAs that submitted financial statements on time (twenty out of thirty-five councils for the year ending June 2018). Moreover, while LAs are required to prepare financial statements using accrual accounting standards, most of them have been unable to meet this standard due to the fact that the non-financial assets have not been valued and devolved to LAs, and



thus they are unable to maintain an asset register. The Accountant General Department (AGD) with NAO agreement has taken steps to provide interim guidelines for the more limited 'accrual stage two' accounting, which will enable local authorities to prepare auditable financial statements.

49. **It is expected that an increasing number of local authorities will submit financial statements in a timely manner, and that this will create demand for additional NAO capacity for timely audits.** A combination of the incentive provided by the PBG, clarification of accounting standards by the AGD and the enhanced capacity support that will be provided through this project, should make it technically feasible and politically attractive for all 28 LAs to prepare timely financial statements over the life of the project. This sub-component will finance the expenditures related to conducting timely financial audits of all local authorities, including through contracting arrangements and operating costs, and will contribute to building NAO capacity to do so sustainably with select equipment and training.

Component 3: Local Authority Performance Improvement Support (US\$18 million equivalent)

50. The project's contribution to LA institutional performance, responsiveness to citizens and the management of resources for service delivery will, in addition to fiscal incentives and policy development (described in Components 1 and 2), include upgrading the quality, intensity and volume of resources allocated to improve LA functional capabilities. This component will support enhanced local government capabilities in three ways:

- i. Ensuring that LAs are sufficiently staffed with capable personnel to perform core functions in relation to accountable resource management and the execution of annual investment plans (Sub-component 3.1)
- ii. Delivering technical and material support to build capacity through thematic and LA-specific performance improvement plans targeted to address performance gaps as identified by the performance assessment (Sub-component 3.2)
- iii. Supporting capacities and mechanisms to promote deliberative dialogue and accountability between citizens and local authorities (Sub-component 3.3).

Sub-component 3.1: Human Resources for Core Functions (US\$0.8 million equivalent)

51. **This sub-component will support government efforts to ensure that LAs are sufficiently staffed with capable personnel for the performance of a set of core functions.** It will support cost effective strategies to alleviate a critically important constraint on locally governed service delivery in Malawi, namely, widespread vacancies against positions authorized by the Establishment Warrants. Filling these positions has been challenging in light of chronic fiscal constraints and a wage bill cap, resistance to redeployments from the center to districts, and limited capacity of the LASCOP. Government continues to work on a comprehensive human resource strategy to address vacancies across functions and sectors, including through functional reviews, rationalization exercises and review of the Establishment Warrants. At the same time, government has developed a transitional strategy to fast track filling a subset of positions that are critical to the core cross-cutting functions of LAs. These positions correspond to key fiduciary functions for resource management and capacity to plan, manage and account for service delivery investments. To this end a task force comprising LASCOP, Department of Human Resource Management and Development (DHRMD), MoLGRD, NLGFC and other relevant MDAs has: (i) defined and



agreed on six clusters of core functions and a minimum number of required positions for each (Table 7); (ii) conducted a comprehensive review of Local Authority staffing against these positions and the Establishment Warrants, which revealed a 56 percent vacancy rate as of September 2019; and (iii) developed a costed plan for filling these positions through a combination of redeployments, promotions and new recruitments. Based on this strategy, the Ministry of Finance, Economic Planning, and Development (MoFEPD) agreed to increase the budget to accommodate corresponding wages over time, beginning with the FY 2019-2020 budget.

Table 7: Minimum Core Positions for Priority Recruitment

Clusters of Core functions	Main provisions in the Authorized Establishment Warrant 5 th November 2015	Minimum Position to be Filled
Development Planning and Budgeting, Physical Reporting, Monitoring, Transparency	<ul style="list-style-type: none"> • Director of Planning • Chief Economist • Principal Physical Planning • Senior Economist • Economist 	Director of Planning and Development (DPD)
		Chief Economist
		Economist
Budgeting Formulation and Execution, Financial Management, Accounting and Reporting, Revenue Mobilization and Administration	<ul style="list-style-type: none"> • Director Finance • Chief Accountant • Accountants • Assistant Accountants 	Director of Finance (DoF)
		Chief Accountant
		Accountant
Procurement Management	<ul style="list-style-type: none"> • Principal Procurement Officer • Procurement Officer 	Procurement Officer
Infrastructure Development, Contract Management, Project Implementation, Engineering Supervision	<ul style="list-style-type: none"> • Director of Public Works • Chief Roads Engineer • Roads Superintendent • Chief Roads Supervisor 	Director of Public Works (DPW)
		Roads Superintendent
Internal Audit	<ul style="list-style-type: none"> • Principal Internal Auditor • Internal Auditor • Assistant Internal Auditor 	Internal Auditor
Administration, Human Resource Management and Development	<ul style="list-style-type: none"> • Director of Administration • Chief Human Resource Officer • Principal Human Resource Officer • Principal Administrative Officer • Administrative Officer • Human Resource Officer • Assistant Human Resource Management Officer 	Director of Administration (DoA)
		Chief Human Resource Officer (CHRMO)
		Human Resource Management Officer (HRMO)

52. **Interventions will support the task force in its efforts including through:** (i) periodic reviews of core functions and corresponding positions; (ii) desk and field reviews of LA staffing and vacancy rates against these positions; (iii) development of annual costed plans for filling core positions through redeployments, promotions and new recruitments; and (iv) implementation costs of the promotion and recruitment processes. The expected result is that the core function vacancy rate will be reduced to an



average of 20 percent across LAs and this injection of capacity will generate significant improvement in performance as measured by the performance assessment.

Sub-component 3.2: Performance Improvement Support (US\$16 million equivalent)

53. **This sub-component will support a systematic approach to the identification, preparation and delivery of performance improvement support to LA officials (administrators and elected councilors) and other local stakeholders targeted to enhance functional capabilities measured by the performance assessment.** In line with its mandate, NLGFC will coordinate the activities, collaborating with relevant MDAs as policyholders and subject matter experts. This sub-component will support three sets of activities: (i) development and delivery of performance improvement plans (PIPs); (ii) piloting a demand-driven Grant for Performance Improvement (GPI), beginning in year 3; and (iii) piloting a system for strengthening the internal audit function in LAs by the Central Internal Audit Unit (CIAU).

54. **Performance Improvement Plans (US\$13.5 million).** As per Figure 4, performance improvement support will follow an annual cycle designed to ensure that it is responsive to empirically established gaps between what currently prevails and may be feasible, is aimed at incremental improvements, and is regularly scrutinized against improved performance as assessed through the annual performance assessment. Support will be provided to enable the following set of interrelated activities.

- i. ***The identification and prioritization of key constraints to performance.*** These have been initially identified during the project preparation process through analysis of audit findings, a field assessment conducted as part of a public expenditure review exercise, extensive consultations and numerous available reports. Key constraints within the ambit of PIPs include: the quality of regulations and guidelines; the functionality of equipment, including ICT soft- and hard-ware; staff technical skills; and the timeliness, accessibility and quality of technical support delivered to LAs via MDAs and contracted service providers. Identification and prioritization will be on an ongoing cycle, based on performance on the assessment and LA self-identification.
- ii. ***Preparation and refining of guidelines, manuals, standard documents, systems and procedures that address capacity gaps and performance shortfalls.*** This activity requires coordination among relevant MDAs, including NLGFC, MoLGRD (planning and budgeting; physical progress reporting and M&E), AGD (financial reporting and accounting; use of IFMIS and asset management), PPDA (procurement and disposal of assets), Ministry of Transport and Public Works (contract management and project implementation). An initial set of priority guidelines related to the conditions, triggers and PMs of the performance assessment has been identified for early completion, dissemination and training, as part of a five-year schedule of such activities, to be refined annually following each performance assessment. This includes: guidelines for developing AIPs; guidelines for procurement for AIP; update of LA accounting and financial management (FM) guidelines. These and others will be periodically revised to reflect lessons from local innovations and adaptations. They will also incorporate citizen engagement and gender sensitive guidelines as developed under Sub-component 3.3, and climate considerations.
- iii. ***Development and delivery of PIPs to address performance shortcomings identified by the performance assessment results.*** Each cycle will involve the development and delivery of two kinds



of PIPs: (1) Thematic PIPs, which address common performance shortcomings and are delivered to LAs across the country; and (2) LA-specific PIPs, which identify customized plans for five of the poorest performing LAs, i.e. those that fail to meet eligibility requirements for the PBG and/or those with the lowest scores on the performance assessment. Depending on the nature of the performance shortcomings, PIPs may include capacity support delivered through a range of mechanisms, including: i) on-the-job or short course training; ii) mentoring or twinning arrangements for specific functions (e.g., support for the preparation of financial statements, monthly financial or physical progress reports; designing of investment projects informed by climate impacts; procurement and contract management etc.); iii) ongoing problem solving arrangements (e.g., a just-in-time IFMIS desk support facility provided by dedicated NLGFC staff). It is anticipated that the bulk of PIPs will entail human resource support, but targeted performance improvement is in some cases likely to require equipment and capital expenditure on ICT-related facilities. PIP preparation will require the LAs and NLGFC to have regard to other development partner support to avoid duplication and promote donor harmonization.

Box 2: Developing and Delivering PIPs

Thematic PIPs will be developed by the NLGFC in coordination with the mandated MDA. LA-Specific PIPs will be developed by teams constituted by the NLGFC, comprising experts from relevant MDAs, together with staff and stakeholders from the LA.

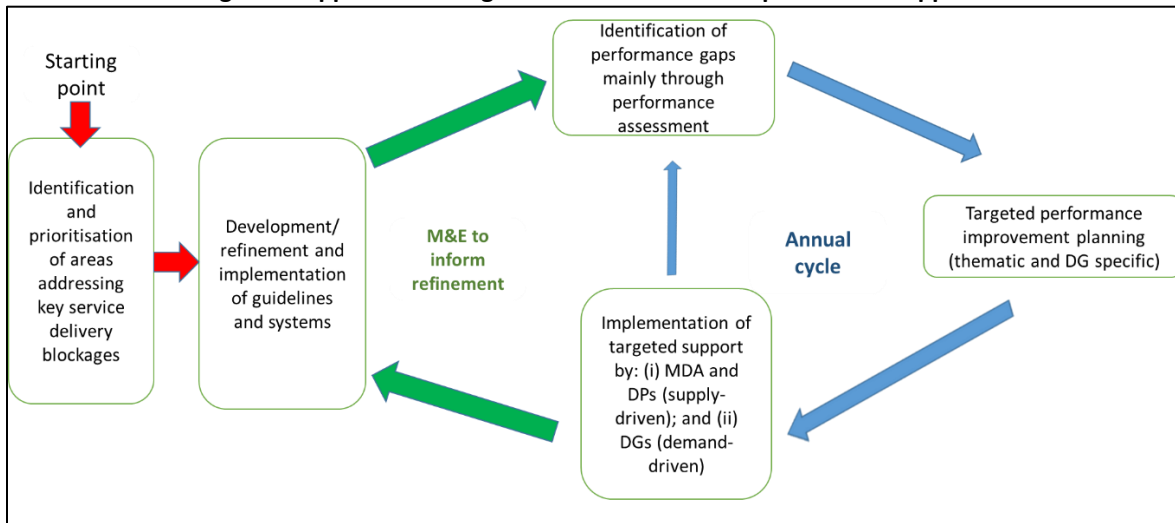
All PIPs will specify:

- Objectives and intended results.
- Activities and delivery modalities which may include: (i) administrative circular and/or administrative action to all LAs; (ii) short-term trainings, seminars, workshops; (iii) hands-on support and on-the-job training, and iv) equipment and facilities (including ICT, HR and IFMIS-related) demonstrably required to lift performance on the assessment
- The facilitators, who may be staff from the relevant MDAs or providers from academic institutions, private firms or CSOs, accountable to deliver PIP activities.
- Budget, timeline and work plan.
- A focal point responsible to oversee implementation.

- iv. **System strengthening, monitoring and learning to ensure quality and relevance of the PIPs, and donor coordination.** The NLGFC will be supported to strengthen its mandated role as coordinator of capacity support to LAs through technical assistance, additional staffing and systems development. Implementation of the PIPs will be monitored through (1) annual review of the PIP approach; (2) review of PIP results and outcomes, against year-on-year changes in the performance assessment scores; and (3) specially targeted research on particular constraints to service delivery outcomes. The performance assessment, coupled with the PIP process, is intended to provide a national framework through which support for local government performance improvement provided by MDAs and donors can be coordinated. As part of the project’s adaptive learning approach each of these steps will be subjected to participatory review based on learning and evaluation (see Component 4).



Figure 4: Approach to Targeted LA Performance Improvement Support



55. **Piloting GPI (US\$1.5 million).** Beginning in year 3 (corresponding with the second round of the PBG), the project will support piloting of a GPI through which eligible LAs can design and implement their own performance improvement plan by procuring relevant technical and training support as appropriate from market providers (academic and vocational organizations, firms, and CSOs) or through agreements with MDAs. While the design of the GPI will continue to be refined, it is likely to be based on the following features:

- i. **Qualification to access the GPI will be assessed as part of the performance assessment.** All 28 LAs will be eligible for the GPI, but each will need to qualify to access the grant by achieving two access conditions: (1) the LA has developed a performance improvement plan that has been approved by the full Council and the NLGFC; (2) the LA has spent the previous year PGI 100 percent in compliance with the investment menu.
- ii. **Allocation and size of the GPI.** The GPI will be a fixed amount (approximately US\$30,000 a year) distributed equally to eligible LAs.
- iii. **Utilization of the GPI.** The investment menu will include skills enhancement through on-the-job or short-term training (minimum 50 percent), and office equipment and systems relevant to alleviating identified performance constraints. Service providers must be selected from a list pre-qualified by the NLGFC.

56. **Piloting strengthened internal audit function (US\$1 million).** The project will support on a pilot basis a facility created by the CIAU to strengthen the internal audit function within LAs. As of 2019, there were only 16 internal auditors across all 35 LAs, and no LAs had a fully functional internal audit system (in which LAs would make adequate budgetary provision, staff would be assigned and facilitated by the Council Executive, reports would be submitted to Council following which internal procedures would be triggered to respond to the internal audit report findings). Building on the capacity support provided by



the World Bank funded FROIP¹⁸, the CIAU has designed a facility whereby the existing 16 LA internal auditors, supplemented by central government internal auditors will form regional clusters that will deploy teams to support the preparation of at least two 6-monthly internal audit reports for each LA. The cluster approach is also intended to protect individual internal auditors from pressure from within the LA. The project will support the CIAU to: (1) conduct a technical assessment of the LA internal audit function; (2) review and develop internal audit instruments and training materials (Internal Audit Manual, IA Charter, terms of references (ToR) for Finance and Audit Committee/Audit Committee Charter, Audit Recommendation Implementation Committee (ARICS)); (3) formulate and implement a detailed internal audit support plan; (4) deliver training and mentoring to existing and newly recruited LA Internal Audit staff and Council committees; and (5) undertake M&E to determine the efficacy of the method to enable the NLGFC to include findings and recommendations on this pilot activity in its annual report.

Sub-component 3.3: Citizen Engagement and Civil Society Partnerships (US\$1.2 million equivalent)

57. **This sub-component will support capacities and mechanisms to promote deliberative dialogue and accountability between citizens and local government.** Enhancing citizen engagement is central to the project design and theory of change, which aims to foster positive, self-reinforcing cycles of institutional reform. Lessons from Malawi's substantial experience with an array of social accountability tools, highlight the need to move beyond citizen engagement as 'consultation' that offers no assurance that concerns will be taken into consideration.¹⁹ They also note the need to shift attention from the process of bottom-up planning (which has attracted significant donor support) to sites of contest where there are high marginal returns on citizen engagement, such as budget and procurement decisions and project transactions. By augmenting the discretionary development resources available to LAs, Component 1 aims to strengthen their 'downward accountability' to citizen priorities. The PBG PMs further incentivize responsiveness through targeted efforts to intensify engagement by LAs with citizens at key points of the project investment cycle. These include the publication of plans and budgets; procurement and expenditure in timely and publicly accessible forms; innovative ways of engaging citizens in social appraisals of investment proposals; public deliberation with councilors of the AIPs before approval and after implementation; organized scrutiny of procurement decisions and results by community groups impacted by or responsible for the assets and services (School Management Committees; Health Clinic Management Committees; community based water groups, market associations, etc.); and publicity of the performance assessment results and how they determine the PBG allocation. Component 2 also promotes information transparency and public dialogue through the annual forum on decentralization and enabling robust audit reports (Figure 5).

¹⁸ Financial Reporting and Oversight Improvement Project (P130878).

¹⁹ Chingaibe, Henry. *Whose Voice? Citizen Participation and Influence in Public Policy Processes in Malawi*, (2012).



Figure 5: Citizen Engagement Across Project Components



58. **This sub-component will finance activities that embed defined roles and processes for citizen engagement within standard institutional procedures, that ensure effective information flows and that establish mechanisms for citizen contestation.** Sub-component 3.3 will be overseen by a Citizen Engagement Committee (CEC), comprised of select civil society organization (CSO) representatives and GoM officials (drawn from NLGFC, MoLGRD, MALGA etc) with 50 percent female participation. The CEC will provide technical advice on the development of guidelines, materials, and CivicTech tools; ensure adequate participation and deliberation in their development; and participate in periodic reviews of their implementation. NLGFC will serve as secretariat to the CEC. Specifically, three sets of activities will be supported:

59. **Institutionalizing citizen engagement in LA service delivery.** The project will support a range of interventions aimed at promoting active contestability and citizen engagement at key points of the annual PBG and project investment cycle. To this end, this sub-component will support:

- i. The development, dissemination and implementation of detailed guidelines laying out the roles, rights and obligations of relevant central MDAs, local councils, the council secretariat, CSOs and individual citizens at each of these stages. These will include: the provision of information (defining content and dissemination methods); annual public forum to discuss the selection of projects for the AIPs prior to Council approval; annual public forum to discuss results of the performance assessment and monitor implementation of the AIPs; support for existing or newly created citizen committees to engage in social appraisal and monitoring of specific investment projects; methods for citizens to ask questions, provide feedback and file grievances and standards for GoM response. All of these guidelines will specifically incorporate gender sensitive standards to promote women’s participation in selection and monitoring (as citizens) and in implementation (as contractors/vendors). They will further lay out gender sensitive standards for the selection and appraisal of AIP projects.



- ii. The establishment of partnerships (through MoUs and/or contracts) between LAs, CSOs and media (print, radio, digital etc.) to disseminate information about performance assessment results, budgets, investment plans and project implementation on a regular basis and in interactive ways. Over time and based on evaluations, this may expand to include information about facility level services (e.g. numbers of teachers deployed to specific schools, medical supplies delivered to health clinics).

60. **Development of a national platform for citizen engagement in local service delivery.** The project will support the development and operationalization of an interactive web-based platform housed and operated by the NLGFC to aggregate LA level information and enable real time feedback and monitoring. The platform will host simplified versions of LA budgets, investment plans and procedures, and will use geo-mapping technology to monitor projects identified in District AIPs allowing for citizen feedback (including uploading photos). This activity will seek to leverage emerging CivicTech innovations.²⁰

61. **Support for local innovations and CSO partnerships.** The project will develop a facility to support strategic partnerships between government (national and district-level) and CSOs that seek to scale up proven social accountability initiatives (for example, scorecards, public expenditure tracking, social audits). The design of the facility, including its governance, eligible projects, selection criteria etc., will be developed by the CEC during the first year of project effectiveness, and will place emphasis on women's empowerment.

Component 4: Adaptive Management and Innovation Support (US\$5 million equivalent)

62. This component has two objectives: i) *Project coordination*: to ensure that the project manages resources wisely and effectively and responds to risks; and ii) *Adaptive learning*: to promote a robust approach to monitoring the efficiency and effectiveness of implementation, encourage innovation and undertake targeted research, and periodically scrutinize the project 'theory of change', including quality and timely technical support and mentoring across project interventions. Key intervention areas in this respect include the following:

Sub-component 4.1: Project Coordination (US\$4 million equivalent)

63. **This sub-component will provide support for the array of project management functions to be undertaken by the NLGFC as implementing agency and by the Project Steering Committee responsible for overall implementation guidance.** NLGFC will undertake the functions of project implementation through a team made of project dedicated officers and regular staff with relevant mandated responsibilities. Support will also be provided for supplemental capacity for procurement, safeguards and communication and to project officers to be deployed in each LA.²¹ The function of project coordination will include:

²⁰ Experimentation will further be supported and extended to other projects by Bank executed resources on citizen engagement.

²¹ This support will be coordinated with that provided by the World Bank Social Support for Resilient Livelihoods Project (MSSRLP).



- i. The maintenance of standards and procedures stipulated in the Project Implementation Manual (PIM), special purpose banking, fiduciary, social and environmental safeguards, financial reporting, procurement, monitoring results (including the project results framework and the inventory of assets created through PBG investments) and undertaking a full Citizen Satisfaction Survey (at baseline, midline and endline), periodic project evaluations including procurement and safeguard reviews.
- ii. Establishing and maintaining an effective system of grievance redress (see project appraisal document (PAD) section IV.C (iii) below) and anti-corruption measures, including close liaison with the Anti-Corruption Bureau and sensitization and awareness of LAs and citizens to prevent misuse of project resources.
- iii. Coordination, communication and outreach to project stakeholders including responsible MDAs, LAs, beneficiaries and donor partners. Effective communications are essential for several reasons: to ensure that LAs are fully aware of the performance assessment measures against which they are being assessed; to foster a healthy competition among LAs and maximize incentives to perform; to enable effective citizen and stakeholder engagement including feedback loops and contestability; and to enable peer learning. To this end a robust communications strategy will be developed and implemented.
- iv. Coordinating effective change management and skills enhancement for individuals and MDAs with project implementation responsibilities. As a practical way to adopt an approach that combines learning by doing with knowledge transfer, the project will support a partnership with the Uganda Overseas Development Institute (ODI) program on decentralization to provide technical and change management support to the GESD team in the form of peer-to-peer learning and just-in-time flexible technical assistance.

Sub-component 4.2: Adaptive Learning and Innovation (US\$1 million equivalent)

64. **This sub-component will support a robust program of learning and evaluation to test the various aspects of the project design and theory of change and to provide for evidence-based adaptations.** The results-based instrument of the PBG/performance assessment provides a framework for analyzing i) the *effectiveness* of the incentives in improving LA and MDA performance, and ii) the *impacts* of improved performance on service delivery results, where impact parameters include asset quality, affordability, durability access and equity – including gender dimensions) (see Section III.B.). The project will provide support for the development and implementation of a research and learning work plan to inform project adaptation and related government and donor supported interventions. The plan will be approved and reviewed periodically by the project Steering Committee. It will utilize a combination of methods – qualitative and quantitative – and will be carried out through strategic partnerships with research institutes, civil society and development partners. It will incorporate a mix of approaches including ongoing monitoring, process evaluations (PE), assessments of pilot interventions, beneficiary feedback activities, and a selective application of impact evaluations. These will feed into periodic revisions of the performance assessment Manual and relevant GoM guidelines.



Cross cutting areas

65. **Gender and Inclusion:** The project will support gender inclusion in a number of ways:

- i. **Gender benefits of investment projects.** While the bulk of project resources, allocated through the PBG under Component 1, are dedicated to investments in civil assets and improving the functionality of services that are in principle gender neutral, they will have significant positive impacts on women and girls. For example, primary health facilities tend overwhelmingly to favor maternal/child health outcomes, just as the labor-saving effects of upgrading water points, and village level roads connecting households with markets, schools and transport hubs have a disproportionately positive affect on women. Similarly, in recognition of the positive effects on girls' primary school enrollment, completion rates and transition to secondary schooling, all investments in classrooms will include outlays on water and sanitation facilities. The PBG investment menu includes teachers' housing as a means of improving the ability of LAs to attract and retain primary teachers (a majority share of whom are women) to remote locations.
- ii. **Gender sensitive standards for investment projects.** Procedurally, gender issues will be infused throughout the guidelines issued by GoM, and provided for under the PIM, and will be highlighted at strategically important points in the investment management cycle. A gender filter will be applied when prospective projects are being reviewed for inclusion in AIPs as part of the social appraisal; tender documents for civil works will attach positive weights to contractor undertakings with respect to women's employment (in addition to workplace safety); the community level committees responsible to monitor progress will be constituted with gender positive membership provisions; and the year-end dialogue between district councilors and citizens on the LA's performance assessment scores will also provide an opportunity for gender-related commitments to be scrutinized.
- iii. **Gender sensitive performance improvement support.** The support for skilling through training, mentoring and on-job capacity building under the PIPs will also be scrutinized by the NLGFC to ensure that gender aspects have been taken seriously. To this end NLGFC will partner with CSOs especially oriented to promoting gender positive outcomes.
- iv. **Gender focused adaptive learning.** Through the Citizen Engagement Committee (which will have 50 percent female participation) and the learning and innovation Sub-component 4.2 the project will maintain a focus on how to ensure effective women's participation and to assess the impacts of project interventions on women's empowerment.

66. **Climate co-benefits:** MGDS III identifies agriculture, water development and climate change management as one of its priority areas. In particular, the Strategy includes enhancing community resilience to climate change impacts as a desired outcome, with specific related actions. The project will support the GoM's efforts by generating the necessary guidelines and capacity to ensure that the design of investment projects is informed by climate impacts. The project will establish a process for screening, appraisal and evaluation of climate change and extreme weather impacts and risks for projects to be financed by the PBG. To the extent possible and to increase mitigation co-benefits, energy efficiency measures will be considered when prospective projects are being considered for inclusion in the LA AIPs.



The inclusion of climate-related disaster resilience standards in bids for goods, services and works under the project will be encouraged and the project will help to build capacity at the central and local government levels for the inclusion of climate-related criteria in terms of reference and other relevant procurement documents; the nature of these activities will seek to generate adaptation co-benefits. The PIPs will include, where most appropriate, training for establishing and implementing climate-informed guidelines and disaster resilience standards for public infrastructure, management of assets, among other needs identified when preparing the Plans. Citizen engagement and consultations will seek to inform the communities of ongoing resilience and energy efficiency efforts and solicit their feedback.

C. Project Beneficiaries

67. **The primary beneficiaries of the project will be the citizens of the 28 LAs that the project will serve.** The PBG will be made available to Malawi's 28 rural LAs where 83 percent of the population resides (15.4 million citizens) – and over half of which fall below the national poverty line (8.9 million citizens).²² The introduction of the PBG has the potential to significantly increase the discretionary development resources available to local governments (approximately 4 times the current actual outturns) to be spent on locally identified capital investments identified in district development plans that are public goods, related to education, health, water, and markets.²³ By directly linking the availability of funds to local government performance, the project aims to also increase the access and quality of public investments which will positively impact the services received by the rural population.

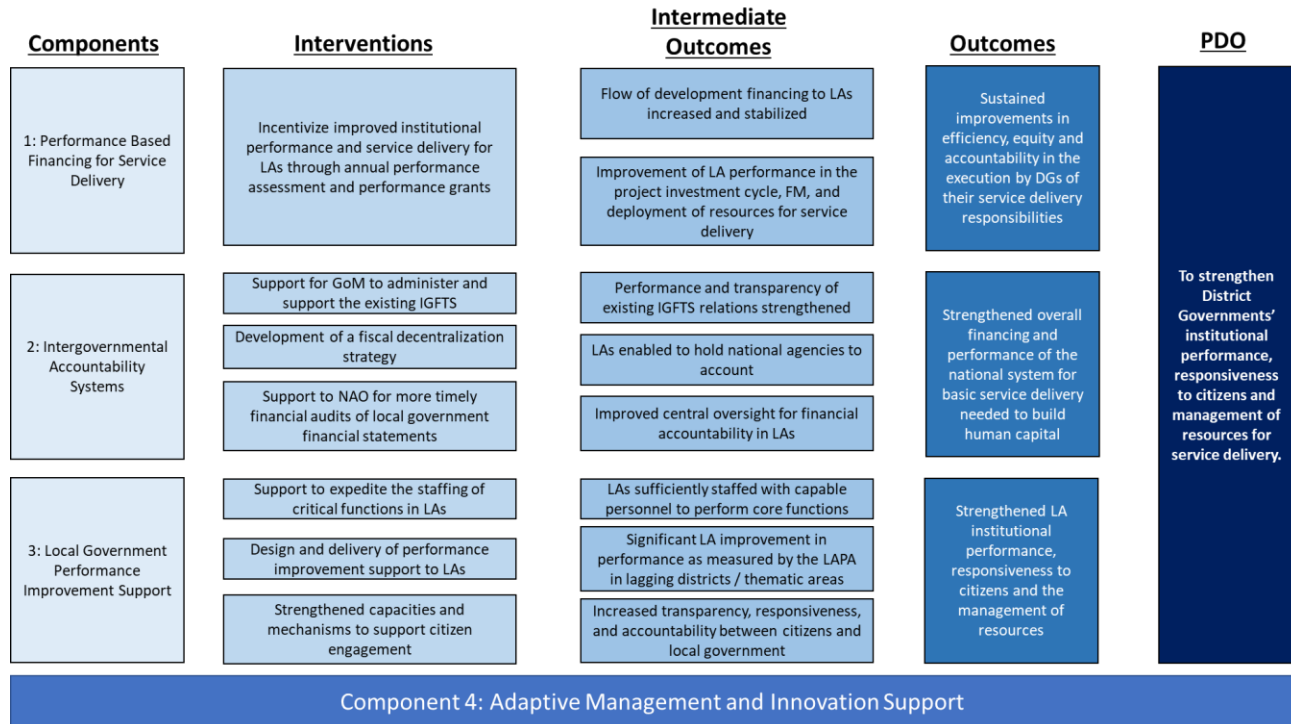
68. **The project will also benefit the capabilities of Malawi's national and local governments with the objective of establishing an architecture which increases confidence to consolidate development expenditure through local government systems.** The design of the project recognizes that strengthening outcomes requires co-production between central and local authorities and a clear link between supported activities and service delivery results. Reforms and capacity building support provided by the project will look to ensure core functions are performed by capable staff and that capacity building measures are targeted at near term improvement in areas identified by the annual performance assessment. The improved performance of LAs will also build confidence in their ability to manage increasing resources in line with their devolved functions, laying a foundation for a coherent framework for national service delivery systems and for crowding in donor funding. Ultimately, this project aims to pave the way for streamlining donor funding through national and local systems so as to avoid some of the complexities and distortions that arise from parallel donor funding streams.

²² International Poverty Line has a value of US\$1.90 PPP.

²³ Over five years an average district could construct: 11 new health centers, 24 new primary schools, 24 new teacher housing, 29 public latrines, and 10 gravity fed pipe water supplies.



D. Results Chain



69. **Malawi’s post-independence trajectory is patterned by repeated cycles in which initial periods of economic stability and growth are interrupted by macro-fiscal shocks that erode capital accumulation and spiral into crippling fiscal deficits.** In the public sector, this manifests into chronic uncertainty and shortfalls in the *fiscal* means to deliver human capital creating services; distorted *structural* relationships between different levels of the state, between elected leaders and the civil service, and with citizens; and shortcomings in how *human resources* are deployed, their skills and motivation. The consequence is the parlous state of the public services critical to human capital formation, thus loading an addition challenge to Malawi’s structural transformation.

70. **While recognizing that many of the contributing factors are beyond the reach of the public sector, the Government commitment is to improve service delivery by injecting more resources through local government institutions and actors.** To achieve the desired results, a politically informed theory of change requires that the project design address each of the above three elements of political economy: *capital*, institutional *structures*, and human *agency*. Under Component 1, the PBG will inject a substantial increase in the volume of development funds into the heart of local governance, namely, the politics of setting budget priorities, allocating resources and converting them into small scale assets. It is assumed that the size of the PBG, together with the incentive-based conditions under which LAs can access them and be rewarded for performance, will revitalize local government systems and procedures, including engagement by locally elected representatives, and further stimulate citizen demand.

71. **Whilst the terms and sufficiency of fiscal resourcing is crucial to local performance it is assumed that local governance and service delivery are a product of the nature and quality of structural relationships ‘above’ local government, with national policy and oversight agencies (Component 2), and**



‘below’ with citizens, both directly through elected councilors and through demand articulated service delivery facilities. The project design casts these relationships in terms of accountability and invests strategically in points where accountability obligations are most likely to impact on how resources are converted equitably and effectively into durable services (the investment budget, procurement, payments, conduct and responses to audit). Improved service delivery requires the confluence of fiscal means and incentives, functional structures of accountability and a third element, the deployment, skills and capabilities of actors in local governance. The project will trigger an immediate upgrading in local government staff to address core functions while at the same time investing in building capacities defined as crucial through the performance assessment process as needed for institutional performance, responsiveness to citizens, and the management of resources for service delivery. The project deliberately creates space for testing these assumptions (Component 4.2) and adapting interventions as needed.

E. Rationale for World Bank Involvement and Role of Partners

72. **The World Bank is uniquely placed to support Malawi to take advantage of recent decentralization momentum by investing in a performance-driven approach to improved service delivery.** The proposed project builds upon long-term experience and continued engagement in SSA and globally to support governments in the design and introduction of PBG systems at the subnational level. In particular, the government is drawing closely on expertise from leaders in the region such as Uganda which pioneered the introduction of such systems almost two decades ago. Since 2014, renewed decentralization momentum including the re-introduction of elected local councilors, the introduction of a development grant, and the devolution of human resources to local authorities have attracted increased attention of donor partners to support local government systems in Malawi. This project can serve as a vehicle for harmonization of support for financing of local service delivery in Malawi and serve as a proof-of-concept for improved LA performance.

73. **The proposed project presents a valuable opportunity to complement ongoing investments by development partners by leveraging comparative advantages.** Currently, the most significant donor partner investment in local governance and decentralization in Malawi is the Local Government Accountability and Performance (LGAP) program. Launched in 2015 by USAID, the program provides central policy support and off-budget technical assistance and capacity building support to eight LAs. As of October 2019, it is now scaling-up to all 28 rural local authorities with the recent introduction of support from United Kingdom Department for International Development (DFID), with a closing date of August 2021. The World Bank has worked closely with both development partners in the design of the proposed project, recognizing the opportunities to complement LGAP’s ongoing technical assistance with results-based financing to help prioritize and incentivize implementation of key functional reforms by both central and local governments. LGAP’s more hands-on capacity building support, in turn, can effectively respond to capacity gaps identified in the local authorities, complement World Bank supervision capacity and mitigate some implementation risks. The project will also complement other ongoing programs supported by donor partners including the training of newly elected local councilors by IrishAid and UNDP, the introduction of Unified Beneficiary Registries (UBRs) through German development agency GIZ/European Union (EU)/DFID’s support to social protection, and the deepening of subnational data and information systems in service delivery sectors.



74. **The proposed project will have substantial synergies with other World Bank financed projects operating at the subnational level.** The World Bank has recently supported operations funding local service delivery for improved social protection (Malawi Social Support for Resilient Livelihoods Project, P169198), primary and secondary education (Malawi Education Sector Improvement Project, P154185 and Equity with Quality and Learning at School, P164223), and early childhood development (Investing in Early Years for Growth and Productivity in Malawi, P164771). These and other operations work through and rely on district structures yet have not historically focused on building the systems and capacity of these structures. Collaboration across the Malawi portfolio will enable the proposed project to build systems and capacities in a manner that will contribute to improved results in these operations. Building on its objectives for institutionalizing structures for improved citizen engagement, the project will also serve as an anchor for a more robust grievance redress and social accountability platform for local service delivery.

F. Lessons Learned and Reflected in the Project Design

75. **The project design draws on lessons learned through a wealth of World Bank operational engagements in governance and service delivery in Malawi and similar countries,** and the knowledge distilled in World Development Reports, in particular, *Making Services Work for the Poor 2004; Development, Security and Conflict 2011; and Governance and the Law 2017*. These lessons are incorporated in five overlapping project design themes.

76. **Political economy and ‘implementation gaps’:** The project design incorporates lessons from common critiques of donor-supported governance and service delivery programming.²⁴ This stresses the need to avoid a technical, input-approach that is preoccupied with the creation of institutional forms and procedure but leads to little change in actual performance. Instead, the project promotes a problem-driven and results-oriented focus, in which governance functions are targeted in ways that are alert to the constraints and opportunities of the institutional landscape and political economy. This features in project design in at least three ways. First, the design process itself took an iterative approach, engaging all relevant stakeholders in the identification of service delivery bottlenecks beginning downstream with user experiences and up the results chain to the facility, through to local government and central government levels. Only at that point technically and politically feasible interventions were identified with potential to deliver functional change. Second, the project uses results-based financing – PBGs – to supplement capacity building with financial incentives for the achievement of clearly defined results. Third, the project reflects the lesson that durable changes in governance institutions arise out of elite contest and citizen engagement rather than simply being the product of managerial innovation or performance. This is one reason why the proposed project focusses on electorally salient development spending and on strategically important points of contestability where political and administrative elites interact (e.g., contracting, payments), and where both engage with citizens (e.g., social appraisal, end year fiscal reporting), in the service delivery results chain.

77. **Donors and the co-production of services for human capital:** Malawi’s experience demonstrates the crucial importance of donor partner contributions to delivery of services needed for human capital formation – donor contributions comprise around 40 percent of the national budget, and in the order of

²⁴ A valuable recent example is Bridges, K and M Woolcock (2017). How (Not) to Fix Problems that Matter: Assessing and responding to Malawi’s history of institutional reform, *Policy Research Working Paper 8289*. The World Bank Group. See also IEG Report No. 103060 (2016).



80 percent of non-wage spending on health and education. In this respect the project design has examined current World Bank experience under the AFR-region Human Capital Plan²⁵. Compelling lessons have been built into this project regarding the need to acknowledge that in Malawi donors have been and will continue to be active partners in the ‘co-production’ of services, together with national ministries, local governments, front line facilities, organized civil society and citizens. This has immediate implications for the modalities of donor engagements. Experience shows that it is possible through the parallel modalities of donor funded vertical projects to bring about rapid improvements in different HC indicators, governance functions and capabilities at different levels in the central-local results chain. But experience also shows that this conventional modality often adds to already fragmented institutions, and thus weakens the long-term relationships of accountability – vertical, horizontal and citizen/downwards – needed for durable results. To the extent possible, the innovations introduced by the project are from the outset designed to be embedded in government systems, rather than rely on the authority of the project agreement and project-specific implementation arrangements. Consistent with this, the proposed project will actively promote regional twinning where these intentions have been promoted (initially through ODI with Ugandan counterparts), and key elements of the 2003 Paris Accord on aid effectiveness relating to donor harmonization (for instance by consolidating a single, donor-supported and government owned local authority performance assessment system), and alignment (for instance by reducing the plethora of parallel project financing and control systems Malawi as a result of building confidence in functioning GoM systems).

78. **Decentralization: design and operational lessons:** During design of the project, a wealth of *operational* experience has been reviewed, reflecting nearly three decades of donor support for administrative, fiscal and political decentralization²⁶. The headline messages from the late 1990s continue to resonate in contemporary reviews, particularly drawing from experience in the countries of east and southern Africa. Five common points include:

- i. the need to engage at multiple levels where service delivery problems are generated. Often this can be at points in the results chain that are to some extent removed from where the issue arises (e.g., the problem of local governments defaulting on an individual vendor contract can often be the result of aggregate cash flow management decisions within the MoFEPD);
- ii. the need for long term commitment by donors to intergovernmental reforms, in recognition of the fact that a) the operational commitments governments can make year to year can be volatile, even where the policy commitment appears to be bipartisan and stable, and b) it may take a decade or more for the systems and procedures supported by international partners to be routinised in local institutions;

²⁵ Notably, through which PFM support has been provided at subnational levels, durable reforms have been implemented in intergovernmental fiscal systems to sustainably finance human capital services and assets, front line service providers have been incentivized through grant access and performance measures, improvements in procurement and HR management have been introduced and innovations in citizen engagement have improved both the quality of services delivered and the accountability of resources allocation and use.

²⁶ The following reflect common lessons learnt since the late 90s, USAID (1998). Impact Assessment, Governance and Local Democracy Project, GOLD, Research Triangle Institute, USA, 13 February; UNDP (1998), Factors to consider when Designing Decentralized Governance Policies and Programs, February, New York; OECD (2004). Lessons Learned on Donor Support to Decentralization and Local Governance, OECD DAC Evaluation Series, Paris.



- iii. the need to anticipate that the commitments made by different parts of central government will be asymmetric and sometimes contradictory (for instance, local government vs finance ministries), and that this will weaken coordination, both inter-ministerial and amongst donors and government through the reform process;
- iv. that the marginal returns on donor investments in capacity building tend to be greater when coupled with additional resources to LGs for investing in services (see PBG theme below); and
- v. regarding citizen engagement, that interactions between citizens and LAs are more successful where 'dual channel support' is provided to both sides of the relationship, rather than focusing only on means of stimulating civil society engagement.

79. **Performance-Based Grants.** The first PBGs targeting governance and service delivery results at the local government level were introduced in Uganda in the late 1990s, but since that time, considerable evidence across multiple countries has been accumulated on the efficacy of this instrument as a means of incentivizing LA performance, delivering assets and services that alleviate critical bottlenecks on human capital formation, facilitating citizen engagement, and routinizing its norms and systems for sustainability. Design of the project revisited Malawi's earlier PBG experience and deliberately drew on regional experience, including through study tours to Uganda and Ghana, where deep experience has been institutionalized. Lesson learned and incorporated include:

- i. **Calibrating the size of the PBG to create performance incentives:** PBGs aim to augment transfers to LGs in ways that partially correct the vertical imbalance but have the principle purpose of incentivizing LAs to more efficiently and effectively raise and utilize existing resources. There is no exact science to either a) determining the appropriate size (on a per capita, or per LA basis) of the PBG, nor b) deciding on the most effective weighting on performance to apply in the formula. Instead, these kinds of design issues have been addressed through extensive dialogue and simulation during project preparation, by drawing on country experiences appropriate to Malawi, and by mutual agreement that the design choices reflected at the time of project effectiveness will be revisited iteratively.
- ii. **Sustainability, and the importance of mainstreaming from the outset:** Analysis was conducted of countries where LA PBGs have been institutionally mainstreamed – where governments have over time committed revenues to fund the grant and maintain the annual performance assessment Framework beyond donor withdrawal²⁷. Conditions vary by country, but in common in these countries the PBG was designed from the outset to emulate an intergovernmental fiscal transfer (rather than a project funding instrument); they maintained a contestable, but comprehensively resourced annual performance review process (such as the performance assessment) through which priority PMs were objectively and credibly assessed; and each had in place credible government-owned fiduciary controls as a result of the initial project backing oversight institutions (NLGFC, NAO, CIAU equivalents) and active donor-funded quality assurance and supervision.
- iii. **Sustainability, and recognizing the limits of Local Authority fiscal incentives:** Whereas experience shows that PBGs can prove a powerful instrument to promote performance, and that they can be

²⁷ Specifically, Cambodia, Uganda, Solomon Islands.



institutionalized in routine practice, it is also important to recognize the inherent limits and countervailing factors.²⁸ Malawi's political settlement creates conditions that are at once adverse and conducive to PBGs, not least because relationships between the country's political executive and donors have created a highly fragmented and dynamic institutional landscape. While this provides space for innovation, many other factors also influence how LAs perform, including the state of intergovernmental relations, and between LAs and citizens as political actors and clients for improved service delivery. The project will aim to create an environment of learning, exchange and adaptation; it will ensure that the performance assessment is thoroughly resourced, that its results feed into an annual forum to promote frank stakeholder exchange, institutes a multi-year policy dialogue through which innovations can be taken seriously and increased accountability promoted amongst the donor and government partners to the co-production of the governance and service delivery outcomes.

80. **Citizen engagement and accountability:** The key lesson from interventions that seek to improve citizen engagement around local level public investment management is the need to focus on particular core governance functions that a) have the largest 'marginal return on effort' – that is, greatest potential impact on the quality and sustainability of the asset/service being delivered; b) are sites where elites (Members of Parliament, councilors, administrative staff, local business suppliers/vendors/contractors) are already engaged and contesting their interests, and c) for which there is a 'menu' of possible ways (rather than only one way) of assisting citizens to engage around that function, around which GESD can support iterative learning. The PBG's Access Conditions and Performance Measures provide several opportunities for the application of this logic.

III. IMPLEMENTATION ARRANGEMENTS

A. Institutional and Implementation Arrangements

81. **The NLGFC will be the implementing agency for the project, responsible for overall project management, implementation and coordination.** The NLGFC is a constitutional body mandated to facilitate fiscal decentralization, FM and local development in local councils. It has dual reporting lines to the MoLGRD and the MoFEPD. This positioning and role make it the most appropriate body to implement the project. In addition, it has served as the implementing agency for World Bank funded social protection projects²⁹ and has benefited from the capacity investments made in that regard such that it is deemed adequate for the implementation of GESD. The project will be managed administratively by NLGFC, which will implement all activities related to project management, flow of funds, central procurements and operational support.

82. **The functions of a Project Implementation Unit (PIU) will be embedded in the existing structure of the NLGFC.** A Senior Officer in NLGFC will act as overall Project Coordinator to coordinate all project activities to enable achievement of the project objectives. The Project Coordinator will handle the day-to-day operations of the project and oversee a team responsible for financial management, procurement,

²⁸ Ackerman, J (2004). 'Co-Governance for Accountability: Beyond 'Exit' and 'Voice', *World Development*, 32(3): 447-463.

²⁹ In 2018 NLGFC merged with the LDF, which implemented four generations of the Malawi Social Action Fund (MASAF) projects. The NLGFC is also the implementing agency for the MSSRLP.



M&E, reporting and safeguards for the project. This team will be comprised of dedicated staff from the Departments of Capacity Building, Finance and Infrastructure for Component 1; from the Department of Finance for Component 2; from the Departments of Capacity Building and Corporate Services for Component 3; and from the Department of Knowledge and Communications for Component 4 and aspects of citizen engagement under Component 3. The project will support hiring of additional staff needed to ensure skills are available to carry out project implementation as well as technical responsibilities. Building on experience from previous and ongoing operations, the project also will contract project officers at the local level to support the day-to-day activities and provide additional capacity to LAs³⁰. This structure will be supported by existing government technical staff designated as GESD desk officers within MoLGRD, MoFEPD, CIAU, NAO, LASCOM, AGD, E-Gov and other implementing partners, for their respective sub-components or activities, to provide coordination and maintain institutional memory and continuity. LAs will sign a participation agreement for the PBG which will set out their implementation responsibilities.

83. **A Project Steering Committee (PSC) and Project Technical Committee will be established within two months from the project effectiveness.** The PSC will be chaired by the Principal Secretary (PS) for MoLGRD and comprise representatives of the Office of the President and Cabinet (OPC) and the MoFEPD, with the NLGFC serving as Secretary to the PSC. The PSC will meet biannually to monitor implementation progress; periodically receive and review reports from the performance assessment Task Force, World Bank supervision missions, technical and quality assurance of consultancies and the deliberations of the annual forum on decentralization; provide guidance, discuss and agree on corrective measures; evaluate recommendations and requests that have policy and institutional implications. The Project Technical Committee will be co-chaired by Director-level staff from the MoFEPD, MoLGRD and NLGFC and will serve to oversee project implementation and coordinate among relevant MDAs. As part of this role, the Project Technical Committee will convene quarterly meetings with designated representatives from the NAO, CIAU, AGD, LASCOM, OPC, E-Gov and other relevant agencies. As set out in Sub-component 3.3, a Citizen Engagement Committee will have oversight over those activities and will report to the Project Technical Committee. One District Commissioner will be represented at each meeting of the Technical Committee.

B. Results Monitoring and Evaluation Arrangements

84. **The project will incorporate a strong M&E approach to track the project results framework and a broader set of outcomes.** NLGFC will be responsible for M&E of the project development outcomes and intermediate outcomes. It will collect, compile and analyze the information and prepare M&E reports as necessary for management, the Steering Committee and the World Bank. The NLGFC will have a dedicated M&E Specialist to track and report the status of result indicators. The executing agencies will be responsible for providing the NLGFC, in a timely manner, information and data on implementation progress and results pertinent to their respective activities.

85. **The results-based instrument of the PBG/performance assessment provides a framework for analyzing** i) the *effectiveness* of the incentives in improving LA and MDA performance; and ii) the *impacts* of improved performance on service delivery results (where impact parameters include asset quality, access, equity, affordability, durability). The performance assessment will be administered by the Task Force, headed by MoLGRD and comprising representatives of relevant MDAs. Results will be analyzed by

³⁰ This support will be coordinated with that provided by the World Bank MSSRLP.



the NLGFC and MoLGRD and shared with LAs and the broader public through the bi-annual District Commissioner forums, through which LAs will also report on progress on implementing AIPs and provide feedback on PIPs.

86. **As set out in Component 4, the project will include a targeted program of learning and evaluation aimed at testing and enhancing the project's theory of change, the effectiveness of interventions and their impact on service delivery outcomes.** It will incorporate a mix of approaches including ongoing monitoring, process evaluations, assessments of pilot interventions, beneficiary feedback activities, and a selective application of impact evaluations. The project will seek to build local capacity through engagement of local academic and research institutions. While the project will finance some parts of these costs, it will continuously seek options to generate other sources of financing. Detailed provisions in respect of project results M&E arrangements will be reflected in the PIM.

C. Sustainability

87. **The project design has sought to anticipate sustainability challenges by emphasizing positive and self-reinforcing cycles of institutional reform,** first, by cost-effectively delivering assets and services crucial to human capital development; second, by cycles of positive return from incremental improvements in the efficiency of subnational authorities, including the ways they and citizens engage; and third, by leveraging this improved coproduction performance into greater funding outlays by central authorities, and by donors more readily adopting national systems and setting aside costly and corrosive vertical/parallel arrangements. Experience elsewhere shows that once embedded, these shifts tend to generate positive political returns such that the reforms are not easily reversed.

88. **Still, the sustainability of results depends on several factors outside the reach of the project: the continuation of the currently favorable policy environment, the impact of historically volatile macro-economic conditions and fiscal realities, and on successfully embedding institutional reforms to support the governance and service delivery outcomes.** The 1998 NDP has proven to be a durable overarching policy framework to guide the restructuring of government and state-society relationships, including the assignment of responsibilities for service delivery. Each of the four elements in this policy framework³¹ have remained politically salient and have in various ways been successfully embedded in neighboring Commonwealth countries from where Malawi has historically drawn inspiration for governance and service delivery reforms. Importantly, service sector policy – in particular, for health and education, which set trends for other sectors – has settled in favor of decentralization, while acknowledging that service delivery results depend on workable, nationally applied agreements about how central, district and local facility levels work together to co-produce services.

89. **Malawi's political settlement which is largely responsible for the chronic gap between policy commitments and their implementation creates both challenges and opportunities.** Positive developments noted earlier in relation to intergovernmental fiscal transfers (the introduction of discretionary development grants) and human resource management (devolution of payroll, establishment warrants, and appointments, postings and transfers) indicate that the political economy of

³¹ National Decentralization Policy has four elements: i) to devolve administrative and political authority to the district level; ii) to integrate government services at the district and lower levels into one administrative unit; iii) to assign functions and responsibilities amongst all levels of government; and iv) to promote popular participation in governance and development'



the public sector could be shifting in directions favorable to the aims of the project. Nonetheless, while PBGs can be powerful instruments to promote and institutionalize better performance, many other factors also influence how local governments perform, including the state of intergovernmental relations, and relations between local governments and citizens as political actors and clients for improved service delivery. Anticipating this reality, the project will aim to create an environment of learning, exchange and adaptation; it will ensure that the performance assessment is thoroughly resourced, that its results feed into national annual forum to promote frank stakeholder exchange, institute a multi-year policy dialogue through which innovations can be taken seriously and increased accountability promoted amongst the donor and government partners to the co-production of the governance and service delivery outcomes.

90. **The stability of all public policy is vulnerable to the compounding of macro-fiscal shocks by domestic policy failures.** The relative macro-economic stability since 2017 is a positive signal (inflation has receded to single digit levels, the Kwacha has been stable against the U.S. dollar, and real GDP growth has ranged between 3.7 percent to 4.4 percent) for the future. Risks remain that national fiscal space may be constrained periodically and this may disproportionately affect local government spending, but there is bipartisan consensus amongst government officials and development partners that any effort to improve service delivery outcomes must foreground local governments and that this is the level of governance around which donors must ‘harmonize and align’.

IV. PROJECT APPRAISAL SUMMARY

A. Economic Analysis

91. **The economic analysis of GESD provides a strong economic rationale for investment in the project.** GESD will strengthen existing government institutions and structures, by financing increases in resources for service delivery, and by incentivizing increases in local government capacity to deliver intervention areas critical to human capital formulation. The economic analysis examines the benefits and costs of the project, as well as the likely impacts of the project. It also provides a justification for public sector intervention. The benefits of the project are consolidated using total investment costs, total operating costs, projected benefits, financial sustainability, financial return on national capital, and costs and benefits.

92. **Methodology.** The cost-benefit analysis, which comprises the main part of the analysis, calculates the net present value based on the benefits stemming from delivery of items from the PBG investment menu, and based on the local government performance improvements incentivized by the PBG and strengthened support from central government agencies. The analysis reviewed the literature on rates of return of PBG investment menu items/sectors with a focus on examples from Malawi, Southern Africa and Sub Saharan African in general. A sample list of the facilities and assets that could be funded by the PBG envelope of US\$70 million provided a reasonable basis for the benefit analysis. This is complemented by benefits from performance improvement, which capture the spill overs on the completion and spending efficiency of projects at the LA level outside of GESD.

93. **Costs.** At US\$100 million, the project will cost around 1.3 percent of GDP and 5.2 percent of annual GoM spending, and therefore has a manageable effect on borrowing. Since 2002, Malawi has experienced low but positive rates of real economic growth. Malawi’s debt-to-GDP ratio of 65 percent for 2019 (IMF



WEO 2019) is relatively high but is projected to fall to around 55 percent by 2024. The total discounted cost of the loan is US\$17.7 million. Other costs, including hiring additional staff for the LAs to meet the minimum access conditions, and a 2.5 percent maintenance cost of expected PBG capital expenditures - total an additional US\$17.4 million.

94. **Benefits.** The economic and social benefit from the major areas of spending identified total US\$43.2 million in discounted terms. This is large, and robust to a number of scenarios regarding project delay, under disbursement, or failures, as outlined in the sensitivity analysis. Channels of potential benefit were analyzed with regard to the intergovernmental fiscal transfer system and their downstream impacts on service delivery. Guideline rates of return, associated risks, and definition of channels between interventions and calculated benefits were compiled for the different PBG investment menu items to inform assumptions and final quantifiable benefits underlying each (see Annex 3). Values are summarized in Table 8 below.

Table 8: Economic Value Summary

Item	Discounted benefit, US\$ million
Costs of loan	-US\$17.6
Costs of maintenance and staffing	-US\$17.4
Education, private return, 730 schools	US\$5.3
Education, additional social return, 730 schools	US\$8.0
Health, 350 facilities	US\$19.4
Water and sanitation, 300 gravity-fed schemes and 900 latrines	US\$8.5
Performance improvement ³²	US\$1.9 ³³
<i>Other measures</i>	
Concept	Measure
NPV	8.2
Internal Rate of Return including all costs ³⁴	33%
Benefits: costs ratio, excluding maintenance and staffing	2.4
Benefits: costs ratio, including fully funded maintenance and staffing ³⁵	1.2

95. **Non-quantifiable benefits.** The efficiency gains stemming from the institutional strengthening focus of the project are not easily quantified. In order to provide a fuller idea of the potential value of the project, these benefits should be taken into consideration. These may include:

- i. **Spillover effects to other areas of spending.** The PBG is intended to spur better local government performance through the incentives generated by its links to the performance assessment, which

³² Modelled gain from 10 percentage point reduction in unfinished projects and 10 percentage other efficiency improvements, on existing financing to LAs for other capital LA development grants for 7.5 years. DDF is assumed to stay constant in US\$ terms, while other grants decline by 5 percent a year. Potential efficiency gains on recurrent expenditure have not been modelled.

³³ This figure is low due to the minimal amount of resources currently devoted to capital development spending through LAs.

³⁴ IRR without maintenance costs is 84 percent - given the level of budgeting and maintenance practices, this is also a feasible scenario.

³⁵ Provided separately – in practice, GoM and communities may not be able to finance 2.5 percent of infrastructure value per year in maintenance costs.



should result in better performance management across LA spending. While this is valuable, it is difficult to find literature on local government fiscal multipliers; and more difficult to estimate a rate of return on every additional Kwacha of effective spending at the district level based on micro-econometric studies. Some attempt has been made to reflect the impact of the performance improvement on social returns in the quantitative analysis, however, this is likely to understate returns from the performance management improvements programmed.

- ii. **Impacts on LA own-source revenue.** Having key staff in place is likely to improve the LAs' abilities to execute their revenue plans as appropriate to the individual authority's context and within the law. The performance assessment design proposes PMs focused on increasing locally raised revenue, which has induced significant real increases in revenue declared as part of LAs' budgets in Uganda (GoU, 2018, 2019).
- iii. **Having key LA staff in place** is clearly likely to be beneficial for LA functionality. 145 staff are missing from the prioritized list of LA staff performing core functions (September 2019). However, the effect of additional management-level staff at the LA on quantifiable outcomes is difficult to separate from other benefits quantified.
- iv. **The effects of improvements in grant design based on project experience as the project continues.** There is a lack of rigorous quantifiable literature on the impact of investment-based learning, so future improvements in design were not included in the quantitative analysis.
- v. **Linking planning (the AIPs) more closely with execution.** This is difficult to quantify, except by way of a secondary effect of better planning, for example higher overall execution. A reduction of unfinished projects has been quantified in the calculation above.
- vi. **Increasing confidence in local government systems.** The positive demonstration effect of GESD is envisaged to increase confidence in GoM local government systems by donor partners, potentially resulting in a "snowball effect" where an increasing amount of support is moved on-budget away from parallel off-budget arrangements. This has not been modeled but it has the potential to significantly increase the returns of the project.

96. **Rationale for GoM investment.** Funding continues to severely lag behind the expanded functions that are being increasingly decentralized to LAs, thwarting confidence in local governance and service delivery systems. Given Malawi's status as a very low-income country, there is unlikely to be a feasible private sector response that can provide a level of access to basic services which is socially optimal. Governments everywhere typically provide basic education and primary healthcare, particularly in contexts where many households do not participate in the cash economy. If Malawi is to capitalize on the momentum of increased decentralization, the moment is opportune to build on the progress of the last several years to strengthen national service delivery systems and coordination between central and local authorities.

97. **Rationale for World Bank support.** The World Bank has unique expertise in this area, with a combination of global knowledge and technical skill in the design and implementation of local service delivery projects in Africa (for example, in Zambia, Kenya, Mozambique, Tanzania and Uganda). Moreover,



the World Bank's convening power provides the opportunity to draw directly from experiences in similar context such as the proposed twinning arrangement with Uganda. The World Bank has the ability to administer projects as far as possible via government systems, at a time when many development partners in the post-Cashgate environment (2013) are more constrained or risk-averse in selecting a delivery mechanism.

98. **Design alternatives.** Two design alternatives are the options to either: (i) 'do nothing'; or (ii) execute the project through the central government as has historically been done. As it relates to doing nothing, it is likely that local government performance and service delivery would continue to deteriorate. Without LAs which are funded sufficiently to be functional, it is unclear that practice changes and learning stemming from other World Bank and Development Partner projects could be absorbed at the level of government which leads on service delivery of critical service areas for growth and poverty reduction. Also, central government execution would ignore the GoM's legal assignment of many basic service responsibilities. LAs serve to benefit from the principle of subsidiarity - decisions made at a level of government 'closer to the people'. LAs may be able to take advantage of: better project selection; lower costs; and higher community buy-in/co-financing, which is crucial given the very low level of government financial support to basic services in Malawi.

B. Fiduciary

(i) Financial Management

99. **The current FM arrangements of the NLGFC and LAs, for the purposes of project management have been assessed as meeting the World Bank's minimum requirements, after taking account of mitigation measures, with a risk rating of substantial.** The NLGFC will be the implementing agency and have responsibility for FM functions (Annex 1). A FM assessment of NLGFC was conducted in accordance with FIM in World Bank Investment Project Financing (IPF) Operations (issued on February 10, 2017 and effective March 10, 2010) to determine if the entity will ensure that (a) the funds will be used for the purposes intended in an efficient and economical manner and that the entity is capable of correctly and completely recording all transactions and balances related to the project; (b) the project's financial reports will be prepared in an accurate, reliable and timely manner; (c) the assets acquired under the project will be safely guarded; and (d) the project will be subjected to auditing arrangements acceptable to the World Bank. NLGFC budgeting and accounting processes are adequate, with use of computerized accounting software for project transaction processing and reporting. At the same time, there are weaknesses in NLGFC monitoring and oversight of LAs, which the project will address through capacity building of the NLGFC.

100. **Significant weaknesses exist in FM capacity at the LAs.** A study was commissioned by the World Bank in December 2019 of LAs' PFM, which informed the FM assessment in respect of the PBG expenditures. There are several weaknesses including: high vacancy rates for FM staff in most LAs, poor and delayed bank reconciliations, qualification of most LAs' accounts, weak internal audit function, and serious recurring issues of control and accountability observed in both internal and external audits. Risks will in part be mitigated by (i) access conditions for the PBG, including submission of annual financial statements in compliance with the Accountant General's circular on preparation of local council audited financial statements that requires accrual basis except for non-current assets which as a minimum



requirement should be listed in a comprehensive asset register, acceptable audit opinion on prior FY accounts which is not adverse or disclaimer, and compliance with eligible expenditures in prior FY; (ii) targeted performance improvement support for LAs including on the drive to fill key vacancies; and (ii) fiduciary measures including opening of LAs' project bank accounts, project internal control procedures, regular supervision and capacity building by the NLGFC, and engagement of CIAU to support LAs' internal audit. The NAO will be the external auditor of the project. Details of the key risks and the corresponding mitigation measures are provided in Annex 1.

(ii) Procurement

101. **Applicable Procurement Procedures.** Procurement activities under the proposed project will be carried out in accordance with (a) World Bank's *Procurement Regulations for IPF Borrowers (Procurement in IPF – Goods, Works, Non-Consulting and Consulting Services; July 2016, revised November 2017 and August 2018)*; (b) World Bank's *Guidelines on Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants, dated July 1, 2016 and*; (c) other provisions stipulated in the Financing Agreement.

102. **Preparation of the Project Procurement Strategy for Development (PPSD).** The Recipient has prepared the PPSD identifying optimum procurement strategies for meeting the development objectives of the project, based on which the Procurement Plan (PP) for the first 18 months has been prepared, setting the selection methods to be used by the Recipient in the procurement of goods, works, non-consulting services, and consulting services under the project. The PP will be updated at least every 12 months, or as required, to reflect the actual project implementation needs. Each update shall require World Bank approval and will be publicly disclosed in accordance with the World Bank disclosure policy. The project will use the World Bank's Systematic Tracking of Exchanges in Procurement (STEP) as a primary tool to submit, review and clear all procurement plans and conduct all procurement transactions for the project. The PPSD, a summary of which is described in Annex 1, is a living document that should be regularly updated during project implementation to provide necessary justifications for procurement arrangements, procurement plans, and their updates.

103. **Procurement Implementation Arrangements.** Procurement implementation, contract management and the related decision-making authority under the proposed project shall be carried out by National Local Governance Finance Committee (NLGFC). The World Bank carried out a Procurement Capacity and Risk Assessment of the NLGFC in November 2019, rating the procurement risk as Substantial. The assessment identified major risks that would adversely affect project implementation if not mitigated. Details of the key risks and the corresponding mitigation measures are provided in Annex 1.

C. Safeguards

(i) Environmental and Social Safeguards

104. **The project's environment and social risk rating is moderate.** Project interventions are expected to yield benefits through the use of a results-based approach to strengthen the management of public resources and address governance constraints in order to improve service delivery by LAs. The rating is



due to the project financing small scale infrastructure projects including civil works in 28 districts in Malawi.

105. **Safeguards policies triggered by the project.**

- i. **Environmental Assessment OP/BP 4.01:** This project will fund the refurbishment and rehabilitation of existing community infrastructures such as schools, clinics, community centers, bore holes, markets, bus parks, and community feeder roads. The activities involve construction works that may result in the creation of solid waste, noise/air pollution and minor congestion due to the use of vehicles and machinery and impacts on health and safety of workers and persons of the surrounding communities. Since the precise locations of the project interventions are not yet known, an Environmental and Social Management Framework (ESMF) has been prepared to ensure that a process of identifying, assessing, and mitigating environmental and social impacts is integrated in the development of the specific subprojects.
- ii. **Physical Cultural Resources OP/BP 4.11:** There could be a likelihood that assets that have cultural/religious/historical/archeological value may be found due to activities such as drilling of boreholes. In this regard, chance find procedures for handling any asset of value have been prepared and annexed to the Project ESMF.
- iii. **Involuntary Resettlement OP/BP 4.12:** The proposed rehabilitation works will occur on existing facilities and structures, however, loss of land and assets, impacts on the economic and livelihoods of the people in the surrounding areas may occur. This may be due to due to the expansion of structures and rehabilitation and refurbishment of public facilities such as markets, bus shelters, community feeder roads etc. Therefore, a Resettlement Policy Framework (RPF) has been prepared.

106. **The interventions that will pose environmental or social risk are in Component 1 Performance-Based Financing for Service Delivery which will finance much needed small-scale infrastructure across the 28 LAs.** While the civil works may be widely located in terms of geographical spread with sites in multiple locations across 28 LAs, individual subproject footprint is expected to be modest with risks that are site specific, predictable, temporary in nature and with no significant residual impacts following the implementation of prescribed mitigation measures.

107. **Potential environment and social risks associated with the operation include:** construction generated occupational and community health and safety impacts, waste generation, possible land take leading to permanent or temporary loss and relocation and loss of assets, loss of income sources or means of livelihoods within the physical footprint of the sub projects, and possible labor influx and associated risks such as disease transmission, child labor, trafficking in persons and gender-based violence and sexual exploitation and abuse (GBV/SEA). The project has been assessed to have a low risk of GBV/SEA based on a number of factors including a labor influx profile rated low to medium. In that regard, GBV/SEA risks for individual subprojects will be reflected in safeguard instruments and mitigation measures outlined, GBV/SEA requirements and expectations will be included in contractor and consultant bid documents, including ensuring the requirements for code of conducts (CoCs) which address GBV/SEA, and an effective



GRM with multiple channels to initiate complaints including specific procedures for GBV/SEA will be established.

108. **As the project locations have not been identified an ESMF and RPF have been prepared in accordance with WB safeguards policies and the GoM policies and regulations to guide the development of subproject specific Environmental and Social Impact Assessment (ESIAs)/ESMPs and A/RAPs during implementation.** These documents have been disclosed in country by NLGFC on 30 January 2020 and the World Bank's external website on 31 January 2020.

(ii) Other Safeguards

109. **Environment and Social Safeguard Capacity.** The project will be implemented by NLGFC and LAs. NLGFC has in place one environment and social safeguards specialist. This is considered inadequate for sufficient environment and social risk management for two existing projects (MASAF and MSSRLP) as well as this operation. It has, therefore, been recommended that two additional environment and social specialists be recruited to support the current staff at NLGFC. In addition, existing capacity at district level in the form of the Environment District Officer (EDO) will be utilized for supervision and monitoring of environment and social safeguard compliance.

(iii) Grievance Redress Mechanisms

110. **The project will put in place a project level GRM to facilitate individuals and communities voice/express complaints, concerns, queries, clarifications, and feedback.** The GRM will be aligned to local authority structures (Village Development Committees, Area Development Committees and District Councils) in Malawi and consideration will be given to the use of grievance mechanisms that are in existence for other projects. Currently the NLGFC has in place and is managing a grievance mechanism for the MASAF project. The project level GRM will also be used to raise grievances and concerns specifically related to land acquisition, resettlement and compensation. In addition, the project will participate in an emerging pilot effort to create a platform for a country-wide GRM administered by a third party.

111. Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may also submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit <http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service>. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.



V. KEY RISKS

112. **The overall risk rating for GESD is deemed ‘Substantial’ as summarized in the SORT table in the PAD datasheet section.** The key risks and proposed mitigation measures are described below.

113. **Political and governance risks: Substantial.** In February 2020 the Constitutional Court nullified the results of the May 2019 Presidential Elections and called for a new election within 150 days. It is likely this decision will be appealed to the Supreme Court, extending a period of uncertainty that has been accompanied by frequent and increasingly disruptive public demonstrations. Notwithstanding the election results, there remain risks around the potential attempt of politicization of the PBG process and fiscal decentralization reform due to the funding implications to elected officials’ constituencies. As a mitigation measure, a series of technical notes, guidance programs, and public events will be continuously prepared to ensure elected officials, civil servants, and citizens are fully sensitized on the underlying PBG instruments, performance assessment process, and implications. These will be deliberately public and transparent through different platforms to mitigate the risks of interfering with the outcomes.

114. **Macroeconomic: Substantial.** Malawi’s economic growth has continued to recover while recently achieving key milestones of single digit inflation and more predictable exchange rates. As of March 2020, the country is meeting IMF benchmarks and has been downgraded from high external debt distress to moderate. As the COVID-19 crisis extends to Malawi, additional macro pressures are likely to emerge. The economy remains vulnerable to external climate shocks, however, which require significant disaster management relief and affect agricultural productivity. Government missed the revised fiscal deficit target in FY2018/19 and it is recognized that even with increased fiscal discipline, it will still remain challenging to meet the deficit target of 2.5 percent of GDP in FY2019/20. In this constrained fiscal environment, budget volatility risks to threaten the size and predictability of the DDF which the project is meant to supplement through the introduction of the PBG. If economic conditions significantly worsen within the project lifespan, budget fungibility may make it more difficult to sustainably merge the DDF and PBG as anticipated at later stages of the project. This risk is significantly mitigated by the possibility of merging existing transfers into the DDF and by GOM’s commitment to stabilize the DDF as a project disbursement condition.

115. **Sector strategies and policies: Substantial.** The project has been designed to capitalize on recent decentralization momentum, including sector devolution strategies. But currently there is no strategy for matching functional responsibilities with fiscal resources. Potentially impactful legislation such as the Public Sector Bill, the NLGFC Act and amendments to the Local Government Act have yet to be submitted to Parliament. These factors risk hampering LAs from receiving the predictable resources, strengthened capacity and increased discretion needed to meet the targets being incentivized through the project. As a mitigation measure, the project will directly support the design and implementation of guiding policies such as a fiscal decentralization strategy that will allow for more predictability in funding flows and better links between resources and functions. The project is also deliberately fostering collaboration among relevant MDAs to promote coherent sector decentralization strategies.

116. **Technical design of project or program: Substantial.** Because of the number of local governments and central MDAs participating in the project, the technical design risk is rated as substantial. In isolation each sub-component is not technically complex but will require sequenced and coordinated activities by



several actors. During preparation GoM established a very effective coordination mechanism and this is being institutionalized through project implementation arrangements.

117. **Institutional capacity for implementation and sustainability: Substantial.** Implementation of interventions supported by the project span numerous agencies at the central and district levels, creating coordination challenges. Understaffing at various levels together with conflicting mandates of some agencies pose further risks. As a mitigating measure, the project has invested in the formation of a strong project coordination structure – underpinned by joint leadership by the NLGFC, MoLGRD, and MoFEPD and consisting of leadership from key thematic (NAO, CIAU, LASCOM) and service delivery Ministries (Ministry of Health and Population, Ministry of Science, Education and Technology). The project is also providing initial funding for select positions at the NLGFC (procurement, safeguards, capacity building, communications and budget analysts) that are provided in the Establishment, with a pathway to Government funding by the end of the project. In addition, the project will fund the position of Project Officers, one in each LA, which it will share with the MSSLRP to supplement NLGFC capacity at the LA level. As a practical way to adopt an approach that provides capacity support through learning by doing and knowledge transfer, the project will support a partnership with the Uganda ODI program on decentralization to provide technical and change management support to the GESD team in the form of peer-to-peer learning and just-in-time flexible technical assistance.

118. **Fiduciary: Substantial.** The current fiduciary arrangements of the NLGFC for the purposes of project management have been assessed as having substantial risk. The bulk of the project resources are expected to be used in local authorities where FM arrangements are operating in a very weak control environment. These risk factors include high vacancy rates for FM staff in most local councils, delayed and poor quality of audited financial accounts, and weak internal audit functions at both the NLGFC and local councils. The project will directly support a number of the necessary mitigation measures including filling key fiduciary vacancies in local councils, the provision of targeted capacity building and performance improvement support, and an enhanced monitoring and supervision capacity of the NLGFC. Further mitigation methods are set out in Annex 1 and Box 3.



Box 3: Measures to strengthen country systems against corruption

Analytical work shows that misuse of funds at the District level is prevalent, and to a large extent enabled by: the lack of clear guidance and oversight; unpredictable and non-transparent fund flows; and weak accountability relations between LAs and the center, and LAs and citizens. This enables both those who seek enrichment as well as those who are driven to poor practices to cope with chronic constraints. The political economy of the electoral system further encourages politicians to use development resources for short term, visible, private goods to their constituents, while also using spending/contracting as a means of extending patronage. GESD aims to close opportunities for corruption in the near term, while promoting a virtuous accountability cycle that over the longer term may shift incentives. Relevant design features include:

- Addressing constraints arising from central government that enable corruption by: supporting revision and strengthening of government policy and operational guidance for LA resource management; dissemination and training on the same; renovating the IGFTS; supporting recruitment for core functions; ensuring the annual audit cycle is complete.
- Incentivizing proper PFM practices in LAs through the scrutiny of the performance assessment and the award of performance grants.
- Limiting access to the PBG to LAs that have accounted for funds received through audited financial statements and have used PBG funds 100 percent in compliance with the investment menu.
- Placing Project Officers in each of the LAs to extend the supervision and oversight capacity of the NLGFC
- Supporting strong citizen engagement including active monitoring of investment projects; piloting a third-party run GRM that will encourage candid citizen feedback and monitoring of government responses.
- Establishing a memorandum of understanding (MoU) with the Anti-Corruption Bureau to enable a clear mechanism for following up on corruption allegations.

119. **Stakeholders: Substantial.** Given the nature of the project, which involves coordination between several central and district level MDAs, complex management and reporting structures between various Committees, and the need to involve civil society and coordinate with donors, the stakeholder risks related to this project are substantial. Accordingly, in order to mitigate this risk, the project builds in continuous engagement with all stakeholders and civil society. In addition, the project design includes specific citizen feedback and redress mechanisms including a joint GoM civil society working group for the citizen engagement sub-component.



VI. RESULTS FRAMEWORK AND MONITORING

Results Framework

COUNTRY: Malawi

Malawi Governance to Enable Service Delivery Project

Project Development Objectives(s)

To strengthen Local Authorities’ institutional performance, responsiveness to citizens and management of resources for service delivery.

Project Development Objective Indicators

Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Strengthened institutional performance							
Local Authorities that are eligible for the Performance Based Grant (Number)		0.00	10.00	15.00	22.00	26.00	26.00
Local Authorities that increase their performance assessment score by at least 5 points (Number)		0.00	0.00	15.00	20.00	15.00	15.00
Strengthened management of resources							
Local Authorities that complete 80% of the capital investment projects in their Annual Investment Plans (Number)		10.00	10.00	18.00	22.00	26.00	26.00
Strengthened responsiveness to citizens							



Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Increase in citizen satisfaction (disaggregated by sex) with preparation and implementation of Annual Investment Plans based on periodic beneficiary feedback survey (Percentage)		0.00			15.00		25.00

Intermediate Results Indicators by Components

Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Performance-Based Financing for Service Delivery							
Annual local authority performance assessment conducted on time with quality assurance and results published and used to determine District allocation of the Performance-Based Grant (Yes/No)		No	Yes	Yes	Yes	Yes	Yes
District Development Fund (DDF) released to Local Authorities on time and in full amount allocated in approved budget (Yes/No)		No	Yes	Yes	Yes	Yes	Yes
Local Authorities that submit quarterly physical progress reports for Annual Investment Plan (AIP) projects (Months)		0.00	0.00	8.00	10.00	12.00	15.00



Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Local Authorities that improve their performance on Financial Management and Accounting (Number)		0.00	2.00	8.00	12.00	15.00	18.00
Intergovernmental Accountability Systems							
Progressive improvement in transparency, policy coherence and accountability in intergovernmental fiscal transfer System (IGFTs) (Text)		No fiscal decentralization strategy; IGFTs not transparent	NLGFC publishes annual report on the IGFTs	NLGFC publishes annual report on the IGFTs and submits time-bound strategic commitments to improve transparency, policy coherence and accountability	NLGFC publishes annual report on the IGFTs, progress with strategic commitments, and recommendations on at least one area of reform	NLGFC publishes annual report on the IGFTs, progress with strategic commitments, status of prior recommendations, and recommendations on at least one area of reform	NLGFC publishes annual report on the IGFTs, progress with strategic commitments, status of prior recommendations, and recommendations on at least one area of reform
Local Authority financial statements audited by National Audit Office by December 31 of each year (Number)		0.00	15.00	22.00	24.00	26.00	28.00
Local Government Performance Improvement Support							
Vacancy rate for core functions across Local Authorities (Percentage)		56.00	45.00	35.00	30.00	25.00	20.00
Targeted Local Government Performance Improvement Plans for the bottom 5 scoring Local Authorities developed and implemented (Number)		0.00	3.00	5.00	5.00	5.00	5.00
Local Authorities that each year produce and act on at least 2 semi-annual internal audit reports (Number)		0.00	8.00	12.00	18.00	22.00	26.00
Gender sensitive standards for selection of Annual Investment		N/A	Gender sensitive standards developed	Gender sensitive standards developed	Gender sensitive standards incorporated		NLGFC Annual Report reports on use and impact



Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Plan projects in place (Text)				and tested in 2 LAs	in revised: i) District Development Planning System Handbook for District Councils; ii) LA Guidelines for AIP Procurement; and iii) DDF Guidelines		of gender sensitive standards
Improved citizen engagement on Annual Investment Plans as measured by the Performance Measures relating to citizen engagement and access to information (Text)		N/A	Citizen engagement guidelines prepared and incorporated in Planning, Budgeting and DDF Guidelines	Mean scores on performance assessment PMs relating to citizen engagement and access to information improves against previous year	Mean scores on performance assessment PMs relating to citizen engagement and access to information improves against previous year	Mean scores on performance assessment PMs relating to citizen engagement and access to information improves against previous year	Mean scores on performance assessment PMs relating to citizen engagement and access to information improves against previous year

Monitoring & Evaluation Plan: PDO Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Local Authorities that are eligible for the Performance Based Grant	Number of LAs that have achieved Minimum Access Conditions (MACS) and Triggers determined by the performance assessment.	Annual	Performance assessment report	Independent Agency contracted to conduct performance assessment assesses MACs as per performance assessment Manual; validated by	MoLGRD



				performance assessment Task Force, and independently verified by quality assurance report	
Local Authorities that increase their performance assessment score by at least 5 points		Annual	Performance assessment report	Independent Agency contracted to conduct performance assessment assesses MACs as per performance assessment Manual; validated by performance assessment Task Force, and independently verified by quality assurance report	MoLGRD
Local Authorities that complete 80% of the capital investment projects in their Annual Investment Plans	Capital investment projects are considered completed when handover is certified. Applies to capital investment projects that are specifically planned to be completed in that year as per approved AIP. Includes only projects funded by the DDF and PBG	Annual	Performance assessment report	Independent Agency contracted to conduct performance assessment assesses MACs as per performance assessment Manual; validated by performance assessment Task Force, and independently verified by quality	MoLGRD



				assurance report	
Increase in citizen satisfaction (disaggregated by sex) with preparation and implementation of Annual Investment Plans based on periodic beneficiary feedback survey	Survey to cover at least 4 aspects of satisfaction with implementation of AIP, such as: knowledge on part of citizens; efficiency of implementation; responsiveness to citizen needs; transparency of process. Survey methodology to be stipulated in the Project Implementation Manual	3 times Baseline (Yr 1) Midline (Yr 3) Endline (Yr 5)	Survey results	Survey conducted and analyzed and reported by independent firm	NLGFC

Monitoring & Evaluation Plan: Intermediate Results Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Annual local authority performance assessment conducted on time with quality assurance and results published and used to determine District allocation of the Performance-Based Grant	Performance assessment process described in assessment Manual and Project Implementation Manual	Annual	Performance assessment report. NLGFC report on Indicative Planning Figures communicated to LAs.	Performance assessment report as validated by performance assessment Task Force and quality assurance report	MoLGRD/NLGFC
District Development Fund (DDF) released to Local Authorities on time and in full	Predictability (no variance between approved budget	Annual	Annual Budget. Mid-	MoFEPD to provide approval budget, and	MoFEPD/NLGFC



amount allocated in approved budget	and actual releases) and timeliness (quarterly releases; with full release by the end of the first month of the fourth quarter) of the DDF.		Year Budget. Copy of LA accounts to show receipt of DDF	midyear revisions to World Bank; NLGFC to collect evidence of actual transfers to LA accounts.	
Local Authorities that submit quarterly physical progress reports for Annual Investment Plan (AIP) projects	Physical reporting as per standard in MoLGRD guidelines	Annual	Performance assessment Report; NLGFC Annual Report; physical inspection (M&E system and web based platform)	Performance assessment Report as validated by LAPA TF and quality assurance report	MoLGRD/NLGFC
Local Authorities that improve their performance on Financial Management and Accounting	LAs that score at least 9 (out of 15) on performance assessment area on Financial Management and Accounting. This performance area provides evidence of institutional performance on proper financial management and accounting	Annual	Performance assessment report	Performance assessment Report as validated by performance assessment Task Force and quality assurance report	MoLGRD
Progressive improvement in transparency, policy coherence and accountability in intergovernmental fiscal transfer System	Standard and content for NLGFC Annual Report to be defined in the Project	Annual	NLGFC Annual Report	As defined in PIM	NLGFC



(IGFTs)	Implementation Manual (PIM). Areas of recommendations to be defined in PIM (to include formulae, structure of grants; equalization; vertical sharing).				
Local Authority financial statements audited by National Audit Office by December 31 of each year	In accordance with the PFM Act	Annual	Performance assessment report	Performance assessment Report as validated by performance assessment Task Force and quality assurance report	MoLGRD/NAO
Vacancy rate for core functions across Local Authorities	Definition of core functions as agreed with LASCOM and HR Task Force and documented in the Project Implementation Manual	Annual	LA human resources annual report	LASCOM /HR Task Force to prepare annual report on recruitments and vacancies against core functions	MoLGRD
Targeted Local Government Performance Improvement Plans for the bottom 5 scoring Local Authorities developed and implemented	The 5 LAs that score the lowest in the Performance Measures of the performance assessment	Annual	NLGFC Annual Report	Reporting on the content and delivery of LA PIPs for the bottom 5 performers	NLGFC
Local Authorities that each year produce and act on at least 2 semi-annual internal audit reports	This will be assessed per performance assessment performance measure 23 (Internal Audit)	Annual	Performance assessment report	Performance assessment report as validated by performance assessment Task Force	MoLGRD



				and quality assurance report	
Gender sensitive standards for selection of Annual Investment Plan projects in place		Annual	District Development Planning System Handbook for District Councils; LA Guidelines for AIP Procurement ; DDF Guidelines; NLGFC Annual Report	Primary documents to be provided to World Bank	MoLGRD/NLGFC
Improved citizen engagement on Annual Investment Plans as measured by the Performance Measures relating to citizen engagement and access to information	Standards as defined by the current performance assessment PMs 2, 10, 11 and 12, which assess extent of LA use of social screening and information flows to citizens	Annual	Performance assessment report	Performance assessment report as validated by performance assessment Task Force and quality assurance report	MoLGRD





ANNEX 1: Implementation Arrangements and Support Plan

COUNTRY: Malawi

Malawi Governance to Enable Service Delivery Project

Project Institutional and Implementation Arrangements

1. **The NLGFC will be the implementing agency for the project, responsible for overall project management, implementation and coordination.** The NLGFC is a constitutional body mandated to facilitate fiscal decentralization, FM and local development in local councils. It has dual reporting lines to the MoLGRD and the MoFEPD. This positioning and role make it the most appropriate body to implement the project. In addition, it has served as the implementing agency for World Bank funded social protection projects³⁶ and has benefited from the capacity investments made in that regard such that it is deemed adequate for the implementation of GESD. The project will be managed administratively by NLGFC, which will implement all activities related to project management, flow of funds, central procurements and operational support.

2. **The functions of a PIU will be embedded in the existing structure of the NLGFC.** A Senior Officer in the NLGFC will act as overall Project Coordinator to coordinate all project activities to enable achievement of the project objectives. The Project Coordinator will handle the day-to-day operations of the project and oversee a team responsible for financial management, procurement, M&E, reporting and safeguards for the project. This team will be comprised of dedicated staff from the Departments of Capacity Building, Finance and Infrastructure for Component 1; from the Department of Finance for Component 2; from the Departments of Capacity Building and Corporate Services for Component 3; and from the Department of Knowledge and Communications for Component 4 and aspects of citizen engagement under Component 3. The project will support hiring of additional staff needed to ensure skills are available to carry out project implementation as well as technical responsibilities. Building on experience from previous and ongoing operations, the project also will contract project officers at the local level to support the day-to-day activities and provide additional capacity to LAs.³⁷ This structure will be supported by existing government technical staff designated as GESD desk officers within MoLGRD, MoFEPD, CIAU, NAO, LASCOS, AGD, E-Gov and other implementing partners, for their respective sub-components or activities, to provide coordination and maintain institutional memory and continuity. Prior to receiving PBG funds LAs will sign a participation agreement which will set out their implementation responsibilities.

3. **A Project Steering Committee (PSC) and Project Technical Committee will be established.** The PSC will be chaired by the PS for MoLGRD and comprise representatives of the OPC and the MoFEPD with the NLGFC serving as Secretary to the PSC. The PSC will meet biannually to monitor implementation progress; periodically receive and review reports from the performance assessment Task Force, World Bank supervision missions, technical and quality assurance of consultancies and the deliberations of the annual forum on decentralization; provide guidance, discuss and agree on corrective measures; evaluate recommendations and requests that have policy and institutional implications. The Project Technical Committee will be co-chaired by Director-level staff from the MoFEPD, MoLGRD and NLGFC and will serve to oversee project implementation and coordinate among

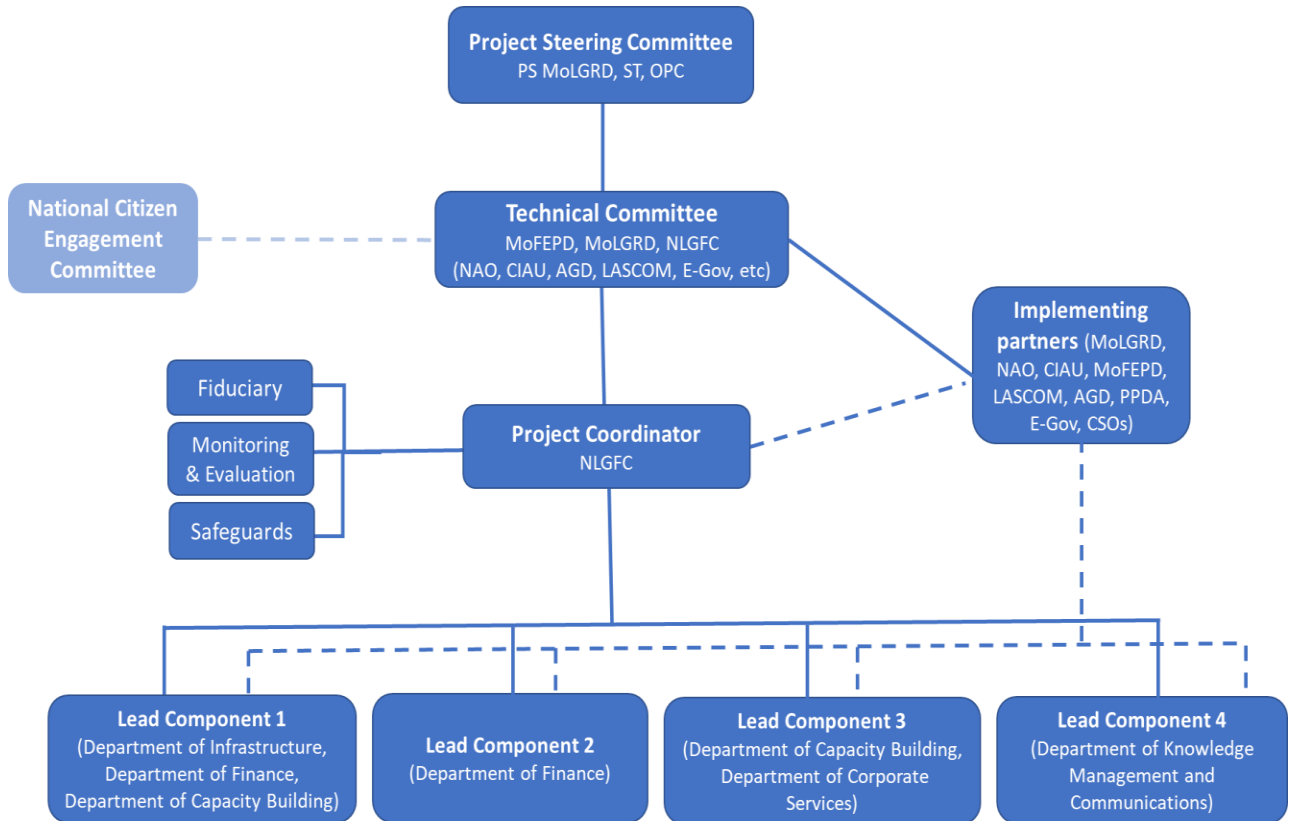
³⁶ In 2018 NLGFC merged with the LDF, which implemented four generations of the MASAF projects. The NLGFC is also the implementing agency for the MSSRLP.

³⁷ This support will be coordinated with that provided by the World Bank MSSRLP.



relevant MDAs. As part of this role, the Project Technical Committee will convene quarterly meetings with designated representatives from the NAO, CIAU, AGD, LASCOM, OPC, E-Gov and other relevant agencies. As set out in Sub-component 3.3, a Citizen Engagement Committee will have oversight over those activities and will report to the Project Technical Committee. One District Commissioner will be represented at each meeting of the Technical Committee.

Figure 1.1: Implementation Arrangements



Fiduciary Arrangements

(i) Financial Management

4. The bulk of the resources will be used at the local council level, but the center is also expected to have a significant share of the resources. NLGFC will be the main implementing agency on behalf of the GoM. NLGFC is currently implementing a safety net project (P133620) financed by the World Bank and will also be implementing entity for the recently negotiated and submitted to the Board project-Malawi Platform for National Social Support Project (P169198). A FM assessment of NLGFC was undertaken to determine if the entity will ensure that (a) the funds will be used for the purposes intended in an efficient and economical manner and the entity capable of correctly and completely recording all transactions and balances related to the project; (b) the project’s financial reports will be prepared in an accurate, reliable and timely manner; and (c) the assets acquired under the project will be safely guarded; and (d) the project will be subjected to auditing arrangements acceptable to the World Bank. The FM assessment was



conducted in accordance with the World Bank Directive: Reference material - FM in World Bank IPF Financing Operations (Catalogue Number OPCS5.05- ID.02) Issued on February 10, 2017 and effective March 10, 2010.

5. **The current FM arrangements for the purposes of project management have been assessed as having substantial risk.** The risks and associated mitigation measures are outlined below and in Table 1. The bulk of the project resources are expected to be used in LAs where FM arrangements are operating in very weak control environment. The existing FM arrangements are affected by the following issues: (i) high vacancy rates for FM staff in most LAs; (ii) local councils use excel spreadsheets for accounting and reporting that is prone to delays and errors; (iii) poor management of LA bank accounts including poor and delayed bank reconciliations ; (iv) delayed and mostly poor audited accounts which for most councils are qualified; (iv) Weak internal audit function at both NLGFC and local councils characterized by very few staff (only one at NLGFC and fifteen for the 28 LAs) and non-functional/weak audit committees ; (v) ineffective monitoring and supervision of local councils by NLGFC staff and (vi) weak managerial accountability with poor application of rewards and punishment, leading to a culture of impunity; (vii) serious recurring issues of control and accountability observed in both internal and external audits.

6. **NLGFC uses computerized accounting software for project transaction processing and reporting but timeliness, comprehensiveness and accuracy of the reports is affected by delays from local councils as well as poor bank reconciliations.** All LAs have computerized accounting systems but most of them do not use the systems for project transaction processing and reporting, instead such transactions and related reporting is done using excel spreadsheets. A separate study of PFM at the local councils was commissioned in December 2019 and completed in February 2020. The findings and recommendations of the study are largely in sync with that of the FM assessment. The findings including the risks and mitigation measures as identified by the LA PFM study have also been incorporated in the Table 1 below.

7. **Budgeting arrangements:** NLGFC budgeting processes are deemed to be adequate. NLGFC will prepare activity based annual work plans and budgets guided by the PAD and based on data and information provided by all the implementing agencies concerned by the project. The budgeting under the project will include the agreed upon project activities and the use of resources earned by means of PBG.

8. **Accounting arrangements:** NLGFC uses the Tompro accounting software for transaction processing and reporting. However, the local councils have been using excel to process and report on project transactions. All local councils will now be required to use computerized accounting software for transaction processing and reporting on the project. All local councils already have computerized IFMIS-Serenic Navigator. An accounting manual will be prepared for the project prior to effectiveness detailing policies and procedures to be followed in carrying out project transactions. NLGFC has adequate qualified and experienced staff that are familiar with FM and disbursements for the World Bank funded operations. The DoF at the NLGFC has the FM oversight of the project and s/he will supervise the project accountants assigned to the project. However, some of the local councils do not have adequately qualified accounting staff. Key accounts staff gaps at the local council will be filled and the DC will assign a qualified accountant to be responsible for the transaction processing and the maintenance of the support documents at the



council. The assigned staff will be supervised by the DoF of the council. This affects both accounting and internal audit staff.

Internal control and internal auditing arrangements

9. **Internal Auditing:** NLGFC and LAs like other government agencies have weak internal audit function with audit committees dormant, consequently issues raised by both internal and external audit reports are not adequately addressed. Government appointed independent audit committees for all ministries but due to lack of funding the committees functioned only briefly and remain dormant for more than three years. The control environment is very weak with many instances of control lapses. This type of environment requires close follow up to ensure controls are adhered to. NLGFC has only one internal auditor while less than half of the 35 LAs have internal auditors. Apart from urban councils those with internal audit function have only internal auditor. Given the high level of noncompliance in LAs, strengthening internal audit function should be a priority to urgently augment the work of NLGFC which monitors and supervises FM in LAs. The size of internal audit at NLGFC should be strengthened including at the councils. Strengthening the oversight function of the internal audit at NLGFC might be effective due to its relative independence from LAs. On the other hand, CIAU could collaborate with the MoLGRD, NLGFC and the councils and establish cluster arrangements for internal audit activities at the councils for the project. The internal audit clusters will support the councils with capacity building and advise on addressing audit queries and assist the councils to submit clean financial statements ready for external audit purposes. The cluster internal audit activities will be carried out risks-based and biannually. The CIAU will coordinate the clusters and submit biannual internal audit reports to the World Bank, MoF and the MoLGRD/NLGFC.

10. **Internal Control Systems:** The accounting manual will specify policies and procedures including internal controls required when using project resources to ensure funds are used for intended purpose in an economical and efficient manner. The World Bank FM team will conduct periodic reviews based on assessed risks and following up on agreed actions meant to strengthen the project FM systems.

Disbursement and Funds Flow Arrangements

11. **Banking arrangements:** NLGFC will open a US\$ designated account (DA) at the Reserve Bank of Malawi or at a commercial bank in Malawi, and a Kwacha operating account, both acceptable to the World Bank. The local councils will open and use exclusive bank accounts at commercial banks in Malawi for the PBG. The PBG bank accounts must be acceptable to the World Bank.

12. **Funds Flow:** Funds flow arrangements for the project are proposed (through the bank accounts above) as follows:

IPF

- The project will be preparing a six-month cash flow forecasts based on agreed work plans and budgets based on which the World Bank (after approval of the forecast) will disburse to the DA or make direct payments.
- IDA will process the agreed and approved withdrawal applications as above and disburse funds to the DA in US dollars.



Table: 1.1: Eligible Expenditure by Category

Category	Amount of the Grant Allocated (expressed in SDR)	Percentage of Expenditures to be Financed (inclusive of Taxes)
(1) Goods, works, non-consulting services, and consulting services operating costs and training for Part 1.1 of the project as follows:		
(a) For the first full FY in which the project is implemented	7,290,000	100%
(b) For the second FY in which the project is implemented	10,935,000	100%
(c) For the third FY in which the project is implemented	14,580,000	100%
(d) For the fourth FY in which the project is implemented	18,225,000	100%
(2) Goods, works, non-consulting services, consulting services, operating costs and training for the project with the exclusion of Part 1.1 of the Project.	20,920,000	100%
(3) Refund of Preparation Advance	950,000	Amount payable pursuant to Section 2.07 (a) of the General Conditions
TOTAL AMOUNT	72,900,000	

Financial Reporting Arrangements

13. **NLGFC will produce quarterly unaudited Interim Financial Reports (IFRs) for the DA and the related project account.** The IFRs are to be produced on a quarterly basis and submitted to the World Bank within 45 days after the end of the calendar quarterly period in accordance with the agreed format and content. The reporting requirements will be incorporated into the accounting software to enable automatic generation of the IFRs.

14. The IFRs submitted to the World Bank will have the following minimum information:

- Statement of Sources and Uses of Funds by category
- Statement of Uses of Funds by Project Activity/Component.
- Designated Account (DA) Activity Statement;
- Bank Statements for both the Designated and Project Account;
- Summary Statement of DA Expenditures for Contracts subject to Prior Review; and
- Summary Statement of DA Expenditures not subject to Prior Review.
- The collaboration and flow of financial and accounting information amongst the implementing entities will be specified in the PIM

Auditing Arrangements

15. **The NAO of Malawi will be the external auditor of the project. The project will procure the services of the external auditor on terms of reference acceptable to the World Bank.** The project will also prepare the annual audited accounts/financial statements which must be submitted to the World Bank within six months after the end of the accounting year i.e. not later than December 31. The audited



accounts will be prepared in accordance with International Public-Sector Accounting Standards. The accounts/financial statements will comprise of the below.

16. **A Statement of Sources and Uses of Funds/Cash Receipts and Payments**, which recognizes all cash receipts, cash payments and cash balances controlled by the entity; and separately identifies payments by third parties on behalf of the entity.

17. **The Accounting Policies Adopted and Explanatory Notes.** The explanatory notes should be presented in a systematic manner with items on the Statement of Cash Receipts and Payments being cross referenced to any related information in the notes. Examples of this information include a summary of fixed assets by category of assets, and a summary of IFR Withdrawal Schedule, listing individual withdrawal applications; and

18. **A Management Assertion** that World Bank funds have been expended in accordance with the intended purposes as specified in the relevant World Bank legal agreement.

Fraud and Corruption

19. **The project will have procedures and controls to ensure that transactions have integrity and fraud and errors are minimized.** The project will be subjected to both external and internal auditing which will further provide assurance about compliance with both World Bank and government policies and procedures.

20. **The World Bank team will ensure the compliance with World Bank procurement and FM rules through its oversight with World Bank procurement and FM specialists’ reviews of documentation, carrying out office visits, interviews and inspections; and recommending actions to be taken if any inconsistencies are identified.** World Bank technical experts will also be involved in the review of all documentation deemed necessary including but not limited to prequalification documents, requests for proposals, ToRs, bidding documents, contract documents, and evaluation awards. In terms government institutional building, the World Bank will ensure that training of staff in procurement and FM issues is offered to strengthen internal technical capacity.

21. **The use of whistle blowers is proposed to further combat corruption and other forms of fraudulent activities.** There are already under the current safety net project being implemented by NLGFC and other World Bank funded projects that use reward anonymous managed by Deloitte.

Table 1.2: Summary of Key Risks and Mitigation Measures

No.	Weaknesses/Risks	Mitigation measures	Responsibility
1	High vacancy rates for FM staff in most LAs	Key vacancies in local councils should be filled. These include internal audit and accounting personnel. The governance project is considering encouraging government to ensure that key service delivery functions including PFM are adequately staffed. The DC will assign a qualified accountant to be responsible for the transaction processing for the project.	NLGFC and MoLGRD



2	LAs use excel spreadsheets for accounting and reporting that is prone to delays and errors	All local councils to use computerized accounting systems for transaction processing and reporting. This should be made as a condition of continued funding. The Governance project is going to incentivize local councils to process and report using computerized software.	NLGFC
3	Poor management of LA bank accounts including poor and delayed bank reconciliations	The project will have an exclusive Dollar and Kwacha accounts at the central bank or in a commercial bank, acceptable to the World Bank. The local councils will also open exclusive bank accounts for the project. NLGFC will ensure that project accounts are reconciled at least monthly. Where required capacity building to be provided to local council staff. Continued funding from IDA to depend on properly reconciled project bank account accounts. The council assigned project accountant will reconcile the exclusive project bank account on monthly basis.	NLGFC and local councils
4	Delayed and mostly poor audited financial accounts which for most LAs are qualified. This is further complicated by accrual accounting requirements at local councils which do not have clear ownership of non-current assets at its disposal	The capacity building should include timely preparation of accurate and complete audited financial statements. The central government is working on transferring ownership of non-current assets to respective local councils. However, this will take time and the government may not have resources to carry out a comprehensive non currents valuation which is required for meaningful financial reporting. For the time being the Accountant General is working on a roadmap towards full accrual compliance. The AG has issued an accrual stage 2 Circular as part of the roadmap. The major exception in this requirement is the exemption of local councils from stating their noncurrent assets at fair values. However, the local councils are expected to prepare a comprehensive noncurrent asset register for all noncurrent assets under their jurisdiction and use	NLGFC and AGD
5	Weak internal audit function at both NLGFC and LAs characterized by very few staff (only one at NLGFC and fifteen for all LAs) and non-functional/weak audit committees	Strengthen internal audit function at the local council level by engaging CIAU. Subject to risk assessment, the CIAU will work with the existing internal audit staff at local councils to ensure each council is internal audited at least once in a year. This arrangement may also be incentivized under the Governance project for service delivery	NLGFC and CIAU
6	Ineffective monitoring and supervision of LAs by NLGFC staff	NLGFC should enhance monitoring, supervision and capacity building of FM in LAs and ensure timely detection of noncompliance and instituting corrective measures. This should be possible with the merger of old NLGFC and LDF that has provided adequate staff with the requisite qualifications and experience in monitoring and supervising local	NLGFC



		councils. The project should make a provision for this enhanced supervision.	
7	Weak managerial accountability with poor application of rewards and punishment, leading to a culture of impunity. serious recurring issues of control and accountability observed in both internal and external audits. This is a consequence of the above listed weaknesses.	Serious and sustained managerial/supervisory accountability within the LAs including application of rewards and punishment. This will contain the moral hazard and culture of impunity that has taken route in the local councils. This should be implemented jointly by NLGFC and Ministry of Local Government. The NLGFC to share reports that confirm the practice of managerial/supervisory accountability including actions taken on issues raised in audit reports	NLGFC and MoLGRD
8	Project resources may be susceptible to fraud and other irregularities.	The Anti-Corruption and Governance arrangements will include: a) an accountability mechanism covering public reporting and use of community volunteers, (b) the use of civil society organizations in social audits and disclosure of project information, and (c) the use of whistle blowers is proposed to further combat corruption and other forms of fraudulent activities. There are already several organizations including World Bank funded activities (Safety net project-P133620) that use reward anonymous managed by Deloitte	NLGFC

22. **Conclusion of the assessment:** The conclusion of the assessment is that the FM arrangements meet the World Bank’s minimum requirements and the project will be expected to implement the mitigating measures articulated above. The risk was assessed as ‘High’ but reduced to ‘Substantial’ in view of the above mitigating measures.

(ii) Procurement

23. Procurement activities under the proposed project will be carried out in accordance with (a) World Bank’s Procurement Regulations for IPF Borrowers (Procurement in IPF – Goods, Works, Non-Consulting and Consulting Services; July 2016, revised November 2017 and August 2018); (b) World Bank’s Guidelines on Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants, dated July 1, 2016 and; (c) other provisions stipulated in the Financing Agreement.

24. **Institutional Arrangements for Procurement.** Procurement under this project shall be carried out by the NLGFC and the twenty-eight (28) Districts Councils (for the Performance Based Procurements).

25. **Procurement Arrangements Under NLGFC:** The World Bank team carried out a procurement capacity assessment of NLGFC in October 2019. The assessment found that NLGFC as a procuring entity has a history of implementing World Bank-funded projects. In compliance with the Public Procurement and Disposal of Assets Act (PPDA), 2017, the NLGFC is a procuring entity with a Procurement and Disposal Unit (PDU) and an Internal Procurement and Disposal Committee (IPDC). The PDU is headed by a Procurement Specialist who is supported by a Procurement Officer, who have formal training in procurement. However, the staff may not be adequate because (a) the merging of LDF and NLGFC have



broaden the mandate of the institution translating to increased procurement transactions to be processed; (b) in addition World Bank funded projects, NLGFC is also implementing procurements funded from its own government budget and those of other development partners; (c) most of the staff who implemented the previous World Bank financed projects including the Procurement Specialist are no longer available under the new institution and current NLGFC procurement staff lack adequate hands-on experience in World Bank’s procurement procedures and regulations. NLGFC’s procurement capacity will therefore, be strengthened through hiring of a dedicated Project Procurement Specialist Consultant with qualifications and experience satisfactory to the World Bank. This will be done in coordination with the MSSRLP to ensure synergies. As part of Project preparation, current NLGFC procurement staff received training on STEP. Additionally, key staff involved in project implementation will receive training on NPF, Selection of Consultants and contract management to enhance their capacity.

26. The above-mentioned assessment rated the overall procurement risk **Substantial**, given the procurement scope and associated risks identified. The assessment findings identified the following weaknesses which could adversely influence the project implementation if not mitigated, including proposed mitigation measures:

Table 1.3: Procurement Risk Assessment and Mitigation Action Plan (NLGFC)

No.	Risk	Risk Type	Mitigation Measure	Time Frame	Responsible Agency
1.	Delays in procurement processing due to limited capacity and staffing, and workload	Substantial	NLGFC will hire a dedicated Project Procurement Specialist with qualifications and experience satisfactory to the World Bank.	Within three months from signing the Financing Agreement	NLGFC
2	Lack of adherence to procedures due to inadequate understanding of the World Bank Procurement Regulations for IPF Borrowers.	Substantial	NLGFC staff involved in project implementation will receive training on the World Bank Procurement Regulations for IPF Borrowers. The World Bank will also provide constant support to staff to ensure adherence to the Procurement Regulations.	Throughout project implementation	World Bank and NLGFC
3	Delays and/or unsuccessful completion of contracts due to inadequate contract management capacity	Substantial	NLGFC will prepare simple contract monitoring sheets for each signed contract for easy monitoring and tracking of milestones. Key staff who will be involved in project implementation will undergo contract management training to enhance their capacity;	Within six months of project effectiveness	World Bank and NLGFC
4	Procurement processing delays due to too many complaints	Substantial	Ensure prompt action on the complaints following the Country and World Bank	Throughout project implementation	NLGFC



No.	Risk	Risk Type	Mitigation Measure	Time Frame	Responsible Agency
			procedures. Use of STEP to register complaints and resolutions, and production of quarterly reports of all complaints received and actions taken.	on	
	Loss and/or unauthorized access to procurement records due to poor record management	Substantial	NLGFC will put in place an effective and secure record management system, with a dedicated staff to manage the records.	During project implementation	NLGFC

Procurement Arrangements Under Performance Grants

27. Procurement under Performance Grants component (Performance Based Procurement) shall be carried by the twenty eight (28) districts councils in accordance with the “World Bank Procurement Regulations for IPF Borrowers” (July 2016, revised November 2017 and August 2018) (“Procurement Regulations”), and the World Bank’s Systematic Tracking and Exchanges in Procurement (STEP) system will be used to prepare, clear and update PPs and document all procurement transactions for the Project.

28. In compliance with the Public Procurement and Disposal of Assets Act (PPDA), 2017, all the District Councils are procuring entities with a Procurement and Disposal Units (PDUs) and an Internal Procurement and Disposal Committees (IPDCs). The World Bank team carried out a procurement capacity assessment of the twenty-eight participating Districts Councils. The assessment reviewed that most PDUs are understaffed or not staffed at all. The key issues and risks concerning procurement for implementation of the project were identified and include: (i) weak educational background of procurement staff directly involved in procurement in some districts; (ii) in other districts, non-availability of specific procurement staff accountable for the day to day procurement activities; (iii) limited experience with donor or World Bank financed procurement processes and procedures; (iv) poor records management - documents are available but filed haphazardly, (vi) thigh retention/transfers of procurement staff.

29. The envisaged procurements to be carried out by the Districts Councils under Performance Based Procurement will be goods and small works of values within the post-review threshold and as such all activities shall follow National Procurement Procedures as described in Section below.

30. The above-mentioned assessment of the District Councils rated the overall procurement risk **Substantial**, given the procurement scope and associated risks identified. The assessment findings identified the following weaknesses which could adversely influence the project implementation if not mitigated, including proposed mitigation measures as below:



Table 1.4: Summary of Procurement Risks and Mitigation Measures (LAs)

No.	Risk	Risk Type	Mitigation Measure	Time Frame	Responsible Agency
1.	Delays in procurement processing due to limited capacity and staffing	Substantial	Deploy/recruit and maintain procurement staff that has the necessary skills acceptable to the World Bank with qualifications and experience satisfactory to the World Bank.	Included in the Access Criteria to be met by all participating District Councils in the first year of the Project	MoLGRD/ LASCOM
			NLGFC to continue dialogue with Government to retain trained staff in the PDU	Throughout project implementation	NLGFC
2.	Lack of adherence to procedures due to inadequate understanding/experience of the World Bank Procurement Regulations for IPF Borrowers.	Substantial	District staff involved in project implementation will receive training on the World Bank Procurement Regulations for IPF Borrowers.	Throughout project implementation	World Bank and NLGFC
			Assign/retain a senior procurement specialist to coach/mentor procurement staff of the District Councils.	In place and to be retained for at least for a year	NLGFC
			Elaborate the procurement management, evaluation and decision-making system, and records management requirements in the in the procurement section of the Operational/Implementation Manual.	Prior to effectiveness	NLGFC
3.	Delays and/or unsuccessful completion of contracts due to inadequate contract management capacity	Substantial	District Councils will prepare simple contract monitoring sheets for each signed contract for easy monitoring and tracking of milestones. Key staff who will be involved in project implementation will undergo contract management training to enhance their capacity;	Within 6 months of project effectiveness	World Bank, NLGFC and District Councils
4	Loss and/or unauthorized access to procurement records due to poor record management	Substantial	Districts will put in place an effective and secure record management system, with a dedicated staff to manage the records.	During project implementation	District Councils

31. **Filing and record keeping.** The Procurement Manual (part of the PIM) will set out the detailed processes for maintaining and providing readily available access to project procurement records, in



compliance with the FA. The NLGFC and District Councils will assign one person responsible for maintaining the records. The logbook of the contracts with unique numbering system shall be maintained.

32. **Commitment control system:** The signed contracts as in the logbook shall be reflected in the commitment control systems or books of accounts as commitments whose payments should be updated with reference made to the payment voucher. This will put in place a complete record system whereby the contracts and related payments can be corroborated.

33. **PPSD:** As part of preparation of the project, NLGFC has prepared its PPSD, using inputs taken from a market survey and analysis of potential consultants and suppliers available for the proposed procurement scope, the assessment of operational context, their institutional capacity as well as procurement related risk analysis. Through these analytical assessments, the PPSD made recommendations on procurement arrangements under the proposed project and the associated PP addresses how procurement activities would support the achievement of the PDO and deliver the best value for money under a risk-managed approach.

34. **Summary of procurement arrangements.** The World Bank has reviewed the outputs of the PPSD developed by the NLGFC and agrees with the proposed procurement arrangements under the project. The procurement method and review thresholds may be subject to the World Bank's review and modification throughout the project period based on the procurement performance and risk rating of the project. The World Bank will make official notice about such changes in a timely manner to ensure smooth implementation.

35. **Procurement templates.** The World Bank's Standard Procurement Documents (SPDs) shall be used for procurement of goods, works, consulting and non-consulting services under International Competitive Procurement. National Bidding documents may be used under national open competitive procurement subject to the exceptions stipulated under paragraph 5.4 of the World Bank Procurement Regulations for IPF Borrowers.

36. **National procurement procedures.** National open competitive procurement procedures may be used while approaching the national market. National open competitive procurement will observe the requirements stipulated in the Procurement Regulations. Other national procurement arrangements (other than national open competitive procurement), that may be applied by the Recipient (such as limited competitive bidding, request for quotations, direct selection), shall be consistent with the World Bank's Core Procurement Principles and ensure that the World Bank's Anti-Corruption Guidelines and Sanctions Framework and contractual remedies set out in the Legal Agreement apply. However, the request for bids/request for proposals document shall require that bidders/proposers submitting bids/proposals present a signed acceptance at the time of bidding, to be incorporated in any resulting contracts, confirming application of, and compliance with, the World Bank's Anti-Corruption Guidelines, including without limitation the World Bank's right to sanction and the World Bank's inspection and audit rights, and that the Procurement Documents include provisions, as agreed with the World Bank, intended to adequately mitigate against environmental, social (including sexual exploitation and abuse GBV), health and safety ("ESHS") risks and impacts.



37. **Procurement Thresholds.** The table below shows the Thresholds and Procurement Methods to be used under the Project given a risk rating of Substantial:

Table 1.5: Procurement Thresholds Methods and Prior-review Thresholds

Prior-review Thresholds		Thresholds for Procurement Methods							
Procurement Type	Substantial Risk (US\$'000)	Works			Goods, IT & Non-Consulting Services			Shortlist of National Consultants	
Works	10,000	Open International or ICB (US\$'000)	Open National or NCB (US\$'000)	Request for Quotation or National Shopping (US\$'000)	Open international or ICB (US\$'000)	Open National or NCB (US\$'000)	Request for Quotation or National Shopping (US\$'000)	Consulting Services (US\$'000)	Engineering and Construction Supervision (US\$'000)
Goods, IT & Non-Consulting Services	2,000	≥	<	≤	≥	<	≤	<	≤
Consultants (Firms)	1,000	7,000	7,000	200	1,000	1,000	100	200	300
Individual Consultants	300								

**These thresholds are for the purposes of the initial procurement plan for the first 18 months. The thresholds will be revised periodically.*

38. **Procurement plan.** NLGFC has prepared a PP for the first 18 months, based on the findings and recommendations of the PPSD. The PP is subject to public disclosure and will be updated on an annual basis or as needed. The updates or modifications of the PP shall be subject to the World Bank’s prior review and ‘no objection’. The World Bank shall arrange for the publication of the PP and any updates on the World Bank’s external website directly from STEP, while NLGFC will do the publication on its project.

39. Each of the District Councils shall prepare a PP based on the approved District Investment Plan and upload in STEP for clearance by the World Bank.

40. **Monitoring by STEP.** STEP will be used to prepare, clear and update procurement plans and conduct all procurement transactions for the project. Through mandatory use of STEP, the World Bank will be able to consolidate procurement/contract data for monitoring and tracking of all procurement transactions. Using STEP, comprehensive information of all prior and post review contracts for goods, works, technical services, and consultants’ services awarded under the whole project will be available automatically and systematically on a real time basis whenever required, including, but not limited to: (a) the reference number as indicated in the PP and a brief description of the contract; (b) the estimated cost; (c) the procurement method; (d) timelines of the bidding process, (e) the number of participated bidders; (f) names of rejected bidders and reasons for rejection; (g) the date of contract award; (h) the name of the awarded supplier, contractor, or consultant; (i) the final contract value; and (j) the contractual implementation period.



41. **Publication of Procurement Information.** The project will follow the World Bank's policies on publication of procurement information that are set forth in the World Bank's Procurement Regulations.

42. **Fiduciary oversight by the World Bank.** The World Bank shall prior review contracts as provided for in the procurement plan. Contracts below the prior review thresholds shall be subject to post review according to procedures set forth in World Bank Procurement Regulations on an annual basis by the World Bank team. The rate of post review is initially set at 20 percent. This rate may be adjusted periodically based on the performance of the Procuring Entity. In addition, World Bank procurement specialist will regularly participate in implementation support missions to assist in monitoring procurement procedures and plans.

43. **Training, Workshops, Study Tours, and Conferences.** Training activities would comprise workshops and training, based on individual needs, as well as group requirements, on-the-job training, and hiring of consultants for developing training materials and conducting trainings. Selection of consultants for training services follows the requirements for selection of consultants above. All training and workshop activities (other than consulting services) would be carried out on the basis of approved Annual Work Plans / Training Plans that would identify the general framework of training activities for the year, including: (i) the type of training or workshop; (ii) the personnel to be trained; (iii) the institutions which would conduct the training and reason for selection of this particular institution; (iv) the justification for the training, focusing on how it would lead to effective performance and implementation of the project; (v) the duration of the proposed training; and (vi) the cost estimate of the training. Report by the trainee(s), including completion certificate/diploma upon completion of training, shall be provided to the Project Coordinator and will be kept as parts of the records, and will be shared with the World Bank if required.

44. **Training Plan.** A detailed plan of the training/workshop describing the nature of the training/workshop, number of trainees/participants, duration, staff months, timing and estimated cost will be submitted to IDA for review and approval prior to initiating the process. The selection methods will derive from the activity requirement, schedule and circumstance. After the training, the beneficiaries will be requested to submit a brief report indicating what skill have been acquired and how these skills will contribute to enhance their performance and to attain the project objective.

45. **Operational Costs.** Operational costs financed by the Project would be incremental expenses, including office supplies, operation and maintenance of vehicles, maintenance of equipment, communication, rental expenses, utilities, consumables, transport and accommodation, per diem, supervision, and salaries of locally contracted support staff. Such services' needs will be procured using the procurement procedures specified in the PIM accepted and approved by the World Bank.

46. **Procurement Manual.** Procurement arrangements, roles and responsibilities, methods and requirements for carrying out procurement under the proposed project shall be elaborated in detail in the Procurement Manual which will be a section of the PIM. The PIM shall be prepared by the Recipient and agreed with the World Bank prior to project effectiveness.

Implementation Support Plan

47. **The proposed implementation plan is based on lessons learned from the implementation of past**



and ongoing projects in Malawi, as well as the project’s specific challenges and risks. Project implementation is the responsibility of the NLGFC, with targeted and continuous implementation support and technical advice from the World Bank. The World Bank’s implementation support will broadly consist of:

- Capacity-building activities to strengthen the ability to implement the project, covering the technical, fiduciary, and social and environmental dimensions;
- Provision of technical advice and implementation support geared to the attainment of the PDOs;
- Ongoing monitoring of implementation progress, including regularly reviewing key outcome and intermediate indicators and identifying bottlenecks;
- Reviewing and verifying DLI protocols;
- Monitoring risks and identifying the corresponding mitigation measures; and
- Close coordination with other development partners to leverage resources to ensure coordination of efforts and avoid duplication.

48. The World Bank’s implementation support team will consist of a Task Team Leader; and country-based and headquarters-based staff in the areas of public sector management, FM, procurement, safeguards and operations. Team members will be responsible for supporting the implementation of project-specific elements in their areas of expertise.

49. **During implementation, fiduciary and other specialists will work with the implementing agency to identify underperforming areas (if any) and address constraints.** Fiduciary support will include review of financial and progress reports prepared by the NLGFC and audit reports prepared by internal and external auditors. Additional implementation support will include review of implementation progress and achievement of project results; providing support for implementation issues and institutional capacity building; and monitoring changes in risks and, as relevant, compliance with legal covenants.

Table 1.6: Focus of Implementation Support

Time	Focus	Skills Needed	Resource Estimate
First twelve months	Technical advice to support project implementation	Technical, fiduciary, operational, environment, and social	2 implementation support visits by technical specialists focused on capacity building, TA, and monitoring 1 implementation support visit by environment and social specialists focused on capacity building and reviewing/strengthening effectiveness of redress mechanism
12–48 months	Continued institutional capacity enhancement to strengthen implementation capacity Implementation M&E	Technical, fiduciary, environment, and social and operational	Bi-annual implementation support visits by technical, fiduciary and safeguards specialists focused on fiduciary support and implementation support, strengthening local capacity, and implementation support



Time	Focus	Skills Needed	Resource Estimate
	Technical advice to support project Implementation		

Table 1.7: Task Team Skills Mix Requirements for Implementation Support

Skills Needed	Number of Staff Weeks per Fiscal Year
Program management (Task Team Leader)	15
Public Sector specialist	8
FM specialist	3
Procurement specialist	3
Operations officer/analyst	4
Social and environmental safeguards specialist	3
Administrative support	2



ANNEX 2: Intergovernmental Accountabilities in Malawi

COUNTRY: Malawi

Malawi Governance to Enable Service Delivery Project

1. This annex sets out supplemental information on decentralization in Malawi to complement the Sector Context and provide baseline analysis underpinning project support for strengthening the fiscal decentralization system (Component 2.1). It draws heavily on the analytical work done for the Malawi Public Expenditure Review (2019-20).³⁸

Policy and Reality: Political Economy of Decentralization

2. **Decentralized service delivery is a frequently contested co-production by multiple national MDAs and subnational levels Local Governments.** Table 1 sets out the critical roles of key MDAs and District authorities regarding budget, finance, accountability, policy and implementation of devolved services, as envisioned by policy and law. Sector policies reflect elaborate norms and standards on equity, affordability and access, and these are articulated through regulations that structure the service delivery obligations from center through lower levels of administrative authority, to facilities and how they interface with citizens. Reflecting similar experiences across the region, Malawi’s decentralization process in fact has ebbed and flowed as shifts in authority in relation to functions, people and finance inevitably raise contests for power. As such, for the first two decades local government administrations remained siloed on a sector basis as the political and bureaucratic leadership of sector ministries continued to dominate the allegiances of district staff as well as budget authority. Donors also played a role in creating and sponsoring institutional arrangements that added to the concentration of executive power at the center, via Sector Wide Approaches (SWAs), and fragmented locally through vertical projects. This has had the effect of blurring intergovernmental accountability systems between and within each level. The disconnect between policy and reality reflects a deeply embedded political economy that challenges the basic patterning of accountabilities needed to ‘make services work for the poor’, namely, three-way relationships of accountability³⁹; vertically, between the center and local governments, horizontally, between elected and administrative officials, and downwards between councils and citizens.

Table 2.1: Institutional Roles in Devolved Service Delivery

Institution	Key roles
MoFEPD	<ul style="list-style-type: none"> - Determines budget ceilings for aggregate LA budget - Determines monthly / quarterly releases based on cash management - Authorizes budget for hiring LA staff
AGD	<ul style="list-style-type: none"> - Sets policy on accounting and financial reporting including use of IFMIS - Executes monthly/quarterly releases
NAO	<ul style="list-style-type: none"> - Conducts statutory audits of LA financial statements
MoLGRD	<ul style="list-style-type: none"> - Sets policy on the operation of Councils and rural development - Coordinates delivery of rural livelihood and empowerment programs
Line Ministries	<ul style="list-style-type: none"> - Policy formulation, establishment of standards and enforcement - Inspection, training, delivery of vertical projects

³⁸ World Bank (forthcoming). Policy Note on Malawi’s Intergovernmental Fiscal Transfer System and Implications for Service Delivery (“IGFTS Policy Note”).

³⁹ World Bank (2004). Making Services Work for the Poor, World Development Report, The World Bank, Washington DC; World Bank (2017). Governance and the Law, World Development Report, The World Bank. Washington DC.



OPC – DHRMD	<ul style="list-style-type: none"> - Sets policy on human resource management - Authorizes recruitments based on MoFEPD budget authorization
NLGFC	<ul style="list-style-type: none"> - Manage fiscal transfers; make recommendations on fiscal decentralization and local revenue mobilization - Consolidate LA budgets and financial reports - Support LAs on compliance for resource management and project implementation
LASCOM	<ul style="list-style-type: none"> - Undertake recruitment for LA staff
District Councils	<ul style="list-style-type: none"> - Set policy and local by-laws - Make planning and budget decisions - Oversee the work of the District Secretariat
District Secretariat	<ul style="list-style-type: none"> - Manage and implement LA operations, including financial management, investment management and service delivery responsibilities - Human resource management for District level staff - District Commissioner serves as Controlling Officer

3. **Establishing a stable match between policy and fiscal outlays has proven challenging.** Nationally, as a share of GDP Malawi outperforms neighbors on health and education spending, although Malawi does less well on per capita spending comparisons. At local level, fiscal transfers to these services have remained relatively constant since 2014, when Malawi’s decentralization policy began to be revitalized, but on a real per capita basis, transfers for health and education have decreased by 25-45 percent for almost all LAs. Malawi has no policy nor tradition that affirms the principle of ‘finance follows function’ that might provide a normative political platform for proponents of more adequate resourcing for health, education and other service facilities, and for the local governments responsible for them. Implicit policy appears to be staying as close to the nominal value of the previous year’s budgets and transfers which in a cash based public finance system are aligned far more to the revenue consequences of macro-fiscal volatility. The NDP 1998 norm that development financing made available to LAs should be ‘at least 5 percent of NNR has not been achieved.

4. **The challenges posed by the disconnect between policy and fiscal commitments are well documented, particularly in relation to human capital-related services which receive the lion’s share of outlays in national and local budgets and by donors.** Health sector strategic policy embarks from acknowledgement that “resources are inefficiently and inequitably allocated and managed at all levels”⁴⁰ and recognises that across all sectors, resources made available to local levels have become “increasingly less sufficient to enable local governments to discharge either their governance or service delivery responsibilities.”⁴¹ Education sector policy is similarly disconnected from the reality of declining quality, access and affordability⁴²; there exist glaring disjunctures in outlays for primary and secondary education, and vast unmet needs for capital spending (a national deficit of 36,000 primary schools alone) that disable the benefits of steady increases in outlays on human resources and pose serious challenges for primary and secondary completion rates, especially for girls. The disarticulation and fragmentation between levels of government and service facilities appears persistently as the most difficult challenge. World Bank analysis of Malawi’s intergovernmental fiscal system conducted as part of the Public Expenditure Review

⁴⁰ Government of Malawi (2018). Health Sector Policy (2017-2020) p. 20.

⁴¹ IGFTS Policy Note.

⁴² The Borgen Project (2018). Facts about Education in Malawi, in <https://borgenproject.org/10-facts-education-in-malawi/>; Unicef (2019). Education Budget Brief, 2018/19, Towards Improved Education for all in Malawi.



concluded that there is a pressing need to review and reformulate intergovernmental fiscal policies, instruments, and institutional responsibilities in Malawi.

Analysis of the Intergovernmental Fiscal Transfer System

5. **General Features of the Intergovernmental Fiscal Transfer System.**⁴³ Malawi’s IGFT system comprises 18 sector transfers for ORT (non-wage recurrent costs), whose objects of spending are largely earmarked by central ministries. Until 2015 the only transfer for development purposes was the CDF, an amount allocated to each Member of Parliament for development projects in their constituencies. In 2015/16, the DDF was introduced, for the first time providing discretionary resources to be used for locally identified priorities.⁴⁴ This was followed in 2016 by the introduction of a transfer earmarked for drilling 4 boreholes per constituency, and a one-year COMSEP transfer intended for social infrastructure projects managed by ADCs and VDCs.

Table 2.2: Summary of the Intergovernmental Fiscal Transfers to LAs

Sector ORT	Start date	Which ministry prescribes policy	Objects of expenditure
Education	2005	Education Science and Technology	Education Methods Advisory Services (Education Standards), management and administration of schools and education services.
Health	2005	Health and Population Services	Primary health care, district hospitals, rural hospitals, Health Center Facility, Clinics, Public health inspection; technical support.
Agriculture	2005	Agriculture and Food Security	RDP, EPA and Section level extension related functions; farmer group mobilization and training, In-service staff training, Message development, District-level inspection and monitoring functions, and District-level coordination of agricultural services.
GRF	2005	Local Government and Rural Development	For councils to manage their daily operations, pay councillors honoraria (20 percent), conduct council meetings
Housing	2006	Land and housing	Provision of office and housing accommodation, rural housing, housing plots, enforcing building standards and regulations, and provision of valuation services.
Trade	2006	Commerce trade and industry	Business licensing, registration of garages and related businesses
Gender	2006	Gender Community Development and social welfare	Economic empowerment of vulnerable groups, provision of social welfare services
Community Development	2006	Information and Civic Education	Provision of community development services

⁴³ For further analysis see: IGFTS Policy Note; Malawi Intergovernmental Fiscal Transfer Study (Dr. J Boex, R Mwadiwa, R Kampanje, Government of Malawi and UNCDF and UNDP) Lilongwe and Atlanta 2001; Study on the Intergovernmental Fiscal Transfers System In Malawi, Final Report May 2008, Dr. Per Tidemand (Team leader), Mr. Alex Mkandawire, Public Finance Expert, Dr. Asiyati Lorraine Chiweza, Local Government Specialist, Mr. Stanley Nyirenda, Institutional Expert, Ms. Nwazi Tamanya Nthambala, Deputy Accountant General and Mr. Chauncy Simwaka, Ministry of Finance.

⁴⁴ Urban LAs have received an Infrastructure Development Fund (IDF) since 2005.



Sector ORT	Start date	Which ministry prescribes policy	Objects of expenditure
Water	2013	Irrigation and water development	Management of water resources, provision of technical services including: borehole siting, supervision of drilling, tendering, etc; Rehabilitation of small dams; protection of catchment areas; water supply and sanitation; maintenance of rural water piped systems, boreholes and community-based management of water resources
Youth	2013	Labour	Youth economic empowerment, participation, leadership, health
Labour	2013	Labour	Employment and labour relations, health and occupational safety and workers compensation
Sports	2013	Sports	Talent identification, mass participation in sports
Forestry/ Environment	2013	Climate change and environment	Extension services for forestry, mining, fisheries, and environment
Fisheries	2013	Agriculture and Food Security	Management of fisheries at district level
Irrigation	2013	Irrigation and water development	Provision of technical support in small scale irrigation
Immigration	2013	Home Affairs and Internal Security	Vetting of passports applications
NRB	2013	Office President and Cabinet	Management of vital statistics of births and certificates
Development Funds	Start date	Which Ministry prescribes policy	Objects of expenditure
CDF	2005	Local Gov and Rural Development	All MPs to implement micro-projects at community level
IDF	2005	Local Gov and Rural Development	Enable urban councils to implement infrastructure improvement in their respective councils
DDF	2015	Local Gov and Rural Development	Provide resources for implementation of DDPs
Boreholes	2016	Local Gov and Rural Development	Enable Las to drill 4 boreholes per constituency
COMSEP	2017/18 only	Local Gov and Rural Development	Enable ADCs and VDCs to implement social infrastructure projects.

6. **There is no effective policy to ensure adequacy of transfers.** Sector ORT transfers do not reflect changes in functional authority, undercutting the principle that finance should follow function. In fact, while LA responsibilities have increased, sector transfers for the two largest sectors – education and health – have decreased in real terms. The Decentralization Policy of 1998 enunciates the principle that development financing made available to LAs should be at least 5 percent of NNR. While the total size of development transfers has increased significantly (from 6 percent of total transfers in 2013/14 to 38 percent in 2018/19), it still falls well short of the policy target, ranging from 0.37 percent of NNR (2013-14) and topping out at 1.65 percent (2017-18). It has also been subject to fragmentation and fluctuation.



Figure 2.1: Composition of Transfers Over Time (by Transfer)

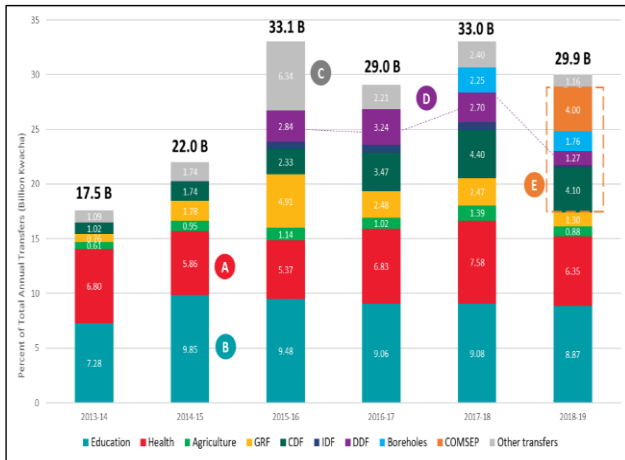
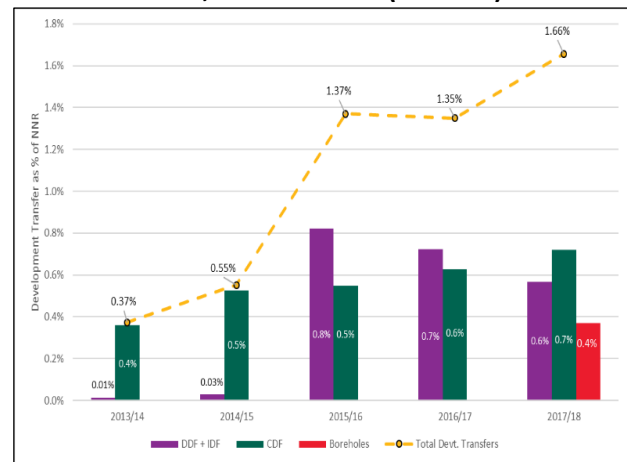


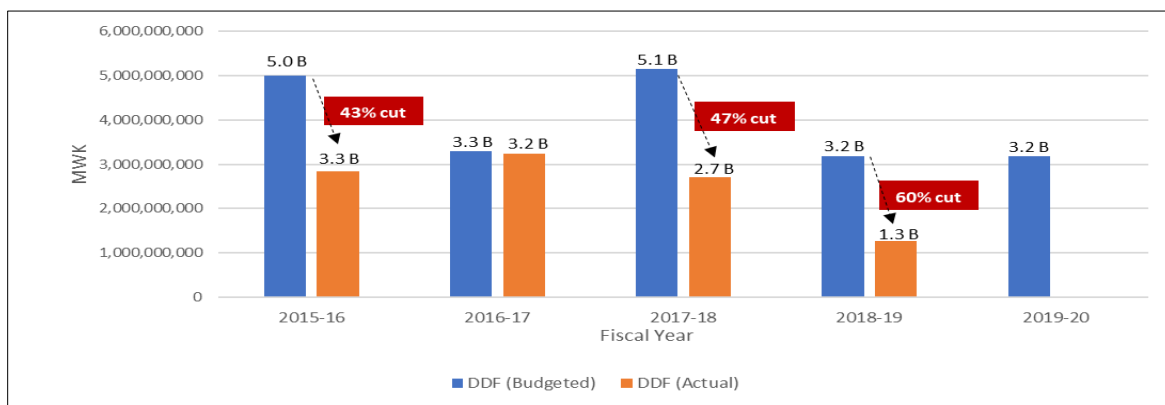
Figure 2.2: Development Transfers as a Share of NNR, FY 2014-2018 (in MWK)



Source: World Bank team, Subnational Public Expenditure Review (2019)

7. **The DDF has suffered the most from unpredictability since its introduction.** As it was originally conceived the DDF was budgeted as MWK 5.0 billion pilot for five councils – but was ultimately spread across all 28 District Councils, diluting its originally intended effect from the start. Transfers are unpredictable, because they are not made in accordance with formulae, but according to itinerant cash management priorities leading to significant variance between approved and actuals – consequently resulting in transfer decisions that are opaque and have little relationship with local authorities’ expenditure needs, or with the differential costs of delivery. Beginning of year budgeted figures have been volatile but settled at MWK 3.2 billion in 2019/20. Actual transfers have regularly been cut, however, averaging a 50 percent reduction in actual receipts from the budgeted amounts in 3 of the past 4 fiscal years (see Figure 3, below). This unpredictability has caused significant delay and increased cost of infrastructure projects. Some district authorities have tried to cope with this constraint through practices of misposting expenditures and inter-borrowing, negotiating cash flow management and informal contracting arrangements. By contrast, the CDF actual transfers have consistently matched approved budgets.

Figure 2.3: DDF Budgeted vs Actual End-of-Year Receipts (by year)



Source: World Bank team, Subnational Public Expenditure Review (2019)



8. Delays and monthly variations in health and education transfers has a negative impact at the facility level. While these sector transfers are generally made in full on an annual basis, monthly cash flow is less predictable as the IGFT system works through cash-based transfers, where the flow of funds passes through several organizations and institutional processes. The flow of funds is administered by the MoFEPD, involves the Accountant General and the Central Bank, and ultimately executes transfers through manual transactions with commercial banks. The coping mechanisms of district administrations result in cash flow management decisions that starve service facilities for certain periods. In some districts, the schools receive funds after much delay, of many months in some cases. Similarly, drug supplies against allocated shares can be inordinately delayed for health centers.

9. The complexity of the transfer system makes it opaque and often not followed in practice. Each transfer is divided according to a specific formula, in some cases highly complex. Due to multiple applications of formulas, by the time the funds reach facilities, it is unclear as to what is the basis of the calculations. For example, in the Education Sector, the transfer is made through 5 different sub-formulas consisting of 12 different variables. Analysis done for the Subnational Public Expenditure Review shows that for a large number of LAs the formula based computed shares were a poor predictor of their actual transfers. Standard practice since 2015 is that annual shares are computed as an incremental change from the previous year, where the increment can vary greatly from one local government to another.

10. The IGFT has a weak equalization effect. Horizontal formulae do not adequately account for differences in size, population and cost of services leading to inequities across the country. There are wide differences in per capita transfers and are not consistently aligned with relative needs and merits. The recipient of the largest education transfers, Mulanje District Council, received MWK 722.9 in 2018 compared to Mwanza District Council, which received MWK 28.5 per capita. Similarly, in the health sector, Likoma District Council received MWK 3151 per capita, twenty-one times the MWK 151 per capita received by Mwanza District Council. In 2018, DDF per capita transfers ranged from a low of MWK 51 (Lilongwe District Council) to MWK 474 (Neno District Council), with Likoma District Council as an outlier at MWK 2,179 (Table 2.4).

Table 2.4: DDF Allocations per capita – Budget Figures Malawi Kwacha – 2018.

District	DDF/capita	2018 Population	Poor Children
Lilongwe District Council	51	1,685,073	53.0%
Mwanza District Council	56	963,401	57.7%
Kasungu District council	64	867,399	59.3%
Mangochi District Council	70	1,181,921	66.3%
Zomba District Council	71	768,379	61.3%
Ntcheu District Council	76	678,737	61.9%
Dowa District Council	79	794,974	54.5%
Machinga District Council	80	756,766	78.6%
Dedza District Council	81	854,597	68.9%
Thyolo District council	82	742,378	70.8%



District	DDF/capita	2018 Population	Poor Children
M'mbelwa District Council	91	703,946	48.0%
Blantyre District Council	93	464,305	46.2%
Salima District Council	99	492,218	65.0%
Mchinji District Council	99	619,772	55.0%
Nkhotakota District Council	105	407,378	61.0%
Nkhatabay District Council	108	294,083	64.9%
Chiradzulu district Council	117	367,224	70.7%
Chikhwawa District Council	121	581,060	69.1%
Karonga District Council	121	375,614	67.4%
Phalombe District Council	131	441,904	86.9%
Ntchisi District Council	132	326,264	60.4%
Balaka District Council	134	451,092	67.9%
Rumphi District Council	160	235,807	60.0%
Chitipa District Council	171	241,740	80.3%
Nsanje District Council	178	307,844	79.7%
Mulanje District Council	437	134,747	74.2%
Neno District Council	474	142,301	52.6%
Likoma District Council	2,179	14,948	33.4%
Mean	102		
standard deviation	399.56		
Coefficient of Variation (CV)	392 %		



ANNEX 3: Economic Analysis

COUNTRY: Malawi

Malawi Governance to Enable Service Delivery Project

1. The economic analysis of GESD provides a strong economic rationale for investment in the program. GESD will strengthen existing government institutions and structures, by financing increases in resources for service delivery, and by incentivising increases in local governments’ capacity to deliver intervention areas critical to human capital formulation. The economic analysis examines the benefits and costs of the project, as well as the likely impacts of the project. It also provides a justification for public sector intervention. The benefits of the project are consolidated using total investment costs, total operating costs, projected benefits, financial sustainability, financial return on national capital, and costs and benefits.

2. Methodology. The cost-benefit analysis, which comprises the main part of the analysis, calculates the net present value based on the benefits stemming from delivery of items from the PBG investment menu, and based on the local government performance improvements incentivised by the PBG and strengthened support from central government agencies. The analysis reviewed the literature on rates of return of PBG investment menu items/sectors with a focus on examples from Malawi, Southern Africa and Sub Saharan African examples. A sample list of the facilities and assets that could be funded by the PBG envelope of US\$70 million provided a reasonable basis for the benefit analysis. This is complemented by benefits from performance improvement, which capture the spill overs on the completion and spending efficiency of projects at the LA level outside of GESD.

3. Costs. At US\$100 million, the program will cost around 1.3 percent of GDP and 5.2 percent of annual GoM spend, and therefore has a manageable effect on borrowing. Since 2002, Malawi has experienced low but positive rates of real economic growth. Malawi’s debt-to-GDP ratio of 65 percent for 2019 (IMF WEO 2019) is relatively high but is projected to fall to around 55 percent by 2024. The total discounted cost of the loan is US\$17.7 million. Other costs, including hiring additional staff for the LAs to meet the minimum access conditions, and a 2.5 percent maintenance cost of expected PBG capital expenditures - total an additional US\$17.4 million.

4. Benefits. The first step in calculating these was an analysis of channels of potential GESD benefits related to the different dimensions of intergovernmental fiscal transfers and their downstream impacts on service delivery. These are described in Table 3.1, below.

Table 3.1: Dimensions of Intergovernmental Transfers and Benefits of GESD

Dimension	Description of anticipated benefit
Adequacy	<p>Increases in investments, given the proposed increase in the DDF via the PBG mechanism, should contribute towards an increase in service delivery in the areas indicated by the investment menu, which should affect access to, and quality of, public services.</p> <p>For example, classroom construction will result in lower Pupil:Classroom Ratios (PCR). The PCR in Malawi was 126 in 2015 (MESIP PAD, 2015), which is likely to be too high for even the most otherwise effective teachers to teach. School construction could form the basis for increased learning outcomes and a resulting increase in future wage earnings. Complementary investments include other World Bank and DP supported interventions. The effect of school</p>



Dimension	Description of anticipated benefit
	<p>construction on learning outcomes – and in turn, income – is mediated via complementary inputs including teachers and teacher supervision and training.</p> <p>Earlier releases during the fiscal year, which result in lower unspent balances, are reflected under <i>efficiency</i> below.</p>
Equity	<p>The adoption of a PBG is likely to involve relatively more funding for the poorest districts, compared to the least-poor districts. Current DDF arrangements do not appear to target either the most populous districts, nor the districts with the poorest population. The project interventions will increase <i>access</i> to basic public services, which is likely to benefit the poor.</p> <p>The current range of per capita values for DDF (the maximum per capita LG level, divided by the minimum per capita LG level) is 43 (2018, in Table 6, DEGE November 2019 report) and this would be expected to narrow to 8 (Table 8, DEGE November 2019 report) on the basic allocation, with higher per-capita amounts to LAs with higher poverty headcounts.</p> <p>The adoption of Performance-based allocations, with 40 percent of the grant value to this portion, is likely to place the range at 18 (see November 2019 DEGE report simulation).</p>
Efficiency	<p>Efficiency improvements can be anticipated, based on the focus areas of the performance assessment in the current PBG design draft and the proposed IPF targeting central government institutions.</p> <p>The proposed guidelines are likely to also clarify the list of excluded items from development grants, which will result in a higher share of capital investment in the DDF.</p> <p>Other areas that may provide efficiencies include:</p> <ul style="list-style-type: none"> ➤ On-time releases leading to lower unspent balances, as well as lower diversion of LA management time into unpredictability coping mechanisms and therefore higher effective resource and managerial availability; ➤ A reduction in the in-year budget-release variation. DDF is currently the most unpredictable grant in terms of the gap between budgets and releases. This reduction is likely attributed to fewer unfinished and late-finished projects⁴⁵ and other performance improvements across the budget cycle. ➤ More transparent and disaggregated fiscal information could lead to lower development partner co-ordination issues and fewer wasteful duplications (see <i>accountability</i> section below).
Accountability	<p>Currently proposed areas of IPF cover a range of accountability improvements. Some of these are highlighted below:</p> <ul style="list-style-type: none"> ➤ Citizen engagement on public investment quality and project choice could result in better-selected, higher-quality, and lower-cost projects (although there is limited evidence at best regarding this, there is related evidence on using the types of information that can be derived from transparency around spending to assist citizens to engage, for example Raffler (2019) and Casey (2015)). ➤ Auditing public expenditure leakage and project completion is likely to lead to expenditure quality improvements and higher induced income. Evidence is strong in this area and includes Olken (2005).

⁴⁵ Research in Ghana (Williams, 2017) indicated that one-fifth of all LG investment was spent on unfinished projects; in Nigeria, the estimate is one-quarter. <https://voxdev.org/topic/infrastructure-urbanisation/unfinished-development-projects-ghana-mechanising-collective-choice>



Dimension	Description of anticipated benefit
	<ul style="list-style-type: none">➤ Increased transparency and subnational financing quality increases may reduce borrowing rates (for instance, Glennerster and Shin 2008; and Sergio and Palomba, 2015).

5. **Rates of Return.** The Economic Analysis survey the rates of return associated with the potential benefits identified through a thorough review of examples of PBG investment menu items with a focus on examples from Malawi, Southern Africa, and SSA. The results of this analysis are captured in Table 3.2, below, which for each intervention area includes: (i) the link between the proposed intervention and calculated benefit; (ii) the strength of the evidence from the literature and indicative measures of improvement; and (iii) risks to benefit realization.



Table 3.2: Guideline Rates of Return and Associated Risks

	Intervention area	Link between intervention and calculated benefit	Strength of evidence from the literature and indicative measures of improvement	Risks to benefit realization
1	Construction of new health centers	<p>Reduces distance to health facility for service users, which may increase access and reduce excess deaths (for example, Karra et al. 2017), as well as freeing-up time for productive activities.</p> <p>May increase staff deployment as an induced investment.</p> <p>Better healthcare allows higher human capital accumulation, leading to higher wages.⁴⁶</p>	<p>Evidence is limited, but there is some high-quality evidence for facility construction and particularly facility density having an impact on key health outcomes.</p> <p>Karra et al 2017: in 21 LMICs, “compared with children who live within 1 km of a facility, children living within 2 km, 3 km, and 5 km of a facility have a 7.7 percent, 16.3 percent, and 25 percent higher odds of neonatal mortality, respectively. Women living farther than 10 km from a facility have a 55.3 percent lower odds of in-facility delivery compared with women who live within 1 km”.</p>	<p>Construction in less-optimal location (examples: Tanzania and Uganda)</p> <p>Malawi’s health infrastructure gap, at over 40 percent (HHFA), mitigates this risk somewhat.</p> <p>This risk of building in the wrong place is mitigated by the PBG formula and perhaps local governments’ greater knowledge of local needs.</p>
2	Rehabilitation of health centers	<p>Better healthcare allows higher human capital accumulation, which leads to higher wages.</p> <p>Rehabilitation may be more cost effective than new construction.</p>	<p>Evidence is limited, but there is some high-quality rigorous evidence for facility rehabilitation if targeted at high-value areas of healthcare and accompanied by skilled staff.</p>	<p>Rehabilitation is targeted at less-optimal locations.</p> <p>Rehabilitation does not focus on high-impact interventions and rather focuses on, for example, fences around facilities rather than maternity-related equipment.</p> <p>This risk is mitigated by the PBG formula and perhaps local governments’ greater knowledge of local needs; the PBG spending guidelines could also assist.</p>
3	Schools rehabilitation	<p>More learning and higher enrolment lead to resulting wage and other</p>	<p>Indirect effects on learning: medium evidence</p> <p>World Bank MEQIP PAD indicated a deficit of 23,000</p>	<p>Construction in wrong place. While primary NER remains low (87 percent),</p>

⁴⁶ There is also an approach using the intrinsic value of additional disability-adjusted life years (WHO), which provides health benefit amounts which are around 20 times per capita GDP in Malawi. Not used here, to allow comparability with the evaluative approach to education, which depends on labor market earnings.



	Intervention area	Link between intervention and calculated benefit	Strength of evidence from the literature and indicative measures of improvement	Risks to benefit realization
		<p>social benefits including better health, delayed pregnancy amongst may other benefits.</p> <p>An additional year of primary schooling has a net social return of 22.1 percent in LICs and over 18 percent for secondary schooling (Psacharopoulos and Patrinos, 2018).</p>	<p>classrooms in 2015; the GESD PAD indicates a deficit of 26,000 primary classrooms in Malawi.</p> <p>Reduced pupil-classroom ratio (PCR) has the potential to enable reduced PTR since there are more classrooms for teachers to teach in, and non-classroom settings are weather dependent).</p> <p>More classrooms and more teachers allow streaming, which may lead to significant learning gains (Evans and Popova 2017).</p> <p>Direct effects on access/enrolment: strong evidence For example, Uganda (RCT, Wodadala et al, 2019) recorded significant impacts of a facilities grant (VIPs, classrooms, teachers’ housing) on early years enrolment (9-30 percent grade 1 year 2, higher in year 1 and grade 2), primary pupil attendance (9.3-17.2 percent in year 1, higher in year 2) and a modest but significant impact on competency test scores (around 1 percent, although they dropped in the first year due to construction).</p> <p>Complementary inputs (teachers and teacher training) could increase the value of rehabilitation work.</p>	<p>primary GER exceeds 100 percent (World Bank, latest).</p> <p>Lack of complementary investments (for instance, teachers and teacher training) leads to delayed, temporary or non-existent attendance gains.</p>
4	New school construction		<p>Additional enrolment has established benefits in terms of the returns from additional human capital</p>	<p>NER is sufficiently high (87 percent, 2017) to require careful selection of the new primary schools locations and to avoid risks that have manifested elsewhere.</p>
5	Teachers’ housing	<p>Reduction in teacher absence and unposted teachers in hard-to-reach</p>	<p>Evidence is limited, but there is some high-quality rigorous evidence for facility rehabilitation in</p>	<p>Costs of teachers’ housing are high relative to anticipated benefit.</p>



	Intervention area	Link between intervention and calculated benefit	Strength of evidence from the literature and indicative measures of improvement	Risks to benefit realization
		communities leads to higher returns to education	<p>general. Uganda (RCT, Wodadala et al, 2019) recorded significant impacts of a facilities grant (VIPs, classrooms, teachers’ housing) on early years enrolment (9-30 percent⁴⁷ grade 1 year 2, higher in year 1 and grade 2), primary pupil attendance (9.3-17.2 percent in year 1, higher in year 2) and a modest but significant impact on competency test scores (around 1 percent, although they dropped in the first year due to construction). Benefits accrued to girls.</p> <p>However, the high unit cost of teacher housing may render it a relatively ineffective investment relative to classrooms or VIPs – there is little support for increasing teacher wages or benefits (including teachers’ houses) without complementary policy actions in the literature.</p> <p>Unit costs for teachers’ houses are high relative to other items on the menu. Supporting teachers to teach better, and increasing capitation grants along with construction is likely to induce a stronger effect on learning (eg Mbiti et al., in Tanzania, 2019).</p>	
6	Sanitation construction (community)	In theory, latrine construction should increase usage and decrease open or other unsanitary defecation; the resulting health benefits manifest through reduced disease risk particularly around diarrhea.	<p>Evidence between construction and latrine use: quality of research is low to very low – Gam et al 2015.</p> <p>Rigorous evidence exists for infrastructure accompanied by training interventions for communities.</p>	<p>Lack of complementary community education interventions seem to diminish effects; LAs guidelines would need to be carefully calibrated to ensure procurement of a more complete package.</p> <p>Guidelines for PBG could be refined to ensure that education accompanies</p>

⁴⁷ Standard errors



	Intervention area	Link between intervention and calculated benefit	Strength of evidence from the literature and indicative measures of improvement	Risks to benefit realization
				construction.
7	Sanitation construction (school)	Less absence of teachers and pupils and better health may result from better on-site facilities Better health outcomes as for box 6.	Little evidence: despite this being intuitively important, there is little rigorous evidence that it makes much difference (there is some correlative evidence, ie BRAC (2011)). The Wodadala et al (2019) study (discussed above) provides some justification for VIP construction as part of the investment menu. Rigorous evidence exists for infrastructure accompanied by educational interventions.	Guidelines for PBG could be refined to ensure that education accompanies construction.
8	Gravity-fed water systems	Better water quality leads to better health outcomes. This results in less burdened health systems, less days lost to illness, and a healthier, more productive workforce.	High effects sizes, but limited evidence on point-of-use filtration (which could be used to justify gravity-fed water systems) (Clasen et al 2018).	Dependent on what piped systems are replacing; and whether maintenance of filtration, piping etc is sufficient to deliver clean water.
9	LA Performance improvement	Better quality planning, procurement, execution, transparency and other performance dimensions leads to more productive investments and increases effective resources available for interventions which contribute to economic growth and poverty reduction.	Strong evidence of variation – government effectiveness has been shown to have large variation in a variety of contexts, with high impacts relative to GDP and government spend (eg. Bandiera et al. 2011, Best et al., 2017). So, the scope for improvement of government unit’s performance is there. More specifically, unit costs per classroom in Malawi are three times higher than those quoted in Tanzania (World Bank, unpublished, 2020), so there is clearly scope for efficiency.	Performance improvement must be linked to behaviours that matter most for service delivery quality. These behaviours may be the most difficult to assess and change.
10	Rural roads	Reduced journey time leads to improved productivity, lower costs, higher availability of inputs and increased access to markets.	Strong – benefits accrue through lower travel time, easier access to education and health care, access to markets.	High unit costs reduce the number of rural roads; project selection and elite capture are, as elsewhere, risks.



6. **Sectoral and Domestic Comparisons.** The Economic Analysis also analysed the rates-of-return of other projects that have utilized PBGs on other potential investment areas. These include:

- In Uganda, the weighted average rate of return for standard protected springs, shallow wells and boreholes is estimated at 18 percent;
- In Indonesia, a newly paved road is estimated to generate an internal rate of return (IRR) of 19 percent and a new market is estimated to produce an IRR of 25 percent;
- In Uganda, construction of a road is estimated to generate an IRR between 27.5 and –33 percent,
- In Ethiopia, investment in drainage produces an IRR of 10.6 percent, and erection and operation of streetlights results in an IRR of 27 percent (Ethiopia, World Bank program economic evaluation, 2018);
- Water and sanitation returns on DFID projects have also been calculated with cost: benefit in the region of 3-4 (i.e. Tanzania, 2012).

An analysis of comparator rates of return, or equivalents, for related projects recently implemented in Malawi are presented in Table 3.3, below.

Table 3.3: Comparator Rates of Return for Malawi, related projects

Sector, Development partner and project	Measure of return
Education World Bank, 2015 <i>MESIP</i>	B:C is 4:1, IRR is 17.7 percent
Education DFID, 2018 <i>Strengthening Malawi’s Education System</i>	B:C ratio is 15.3:1, 10 percent discount rate
Health DFID, 2012 <i>Malawi Health Sector Programme support</i>	US\$295 per DALY, 1.32 b:c ratio for the HSSP, 3.2:1 for DFID support to HSSP, 10 percent discount rate
Transparency and accountability (Agriculture, water examples given) DFID, 2019 <i>TRACTION</i>	Based on an induced 5 percent - 10 percent improvement on maize purchase efficiency over 20 years – b:c ratio of 1.32 to 2.63 Price benefits from reduced water prices as a result of CSO pressure - 5 percent of the price benefit attributed to the project, of the reduction gives b:c ratio of 3.6

7. **Final Benefit and Cost Stream Assumptions.** Based on the reviews performed, the final set of assumptions for each of the benefits streams are details as follows:

- **Education.** The rates of return used were 8.8 percent private, 22 percent primary social and 18 percent secondary social (from Psacharopoulos and Patrinos, 2018). In addition, based on the Uganda research on a similar school infrastructure program described above (Wodadala et al, 2019), a 1 percent increase in the wage premia for primary and secondary leavers was assumed as a quality of education increase stemming from the new infrastructure – although this accounts for a negligible proportion of the total calculated benefit.

Attribution of the additional earnings to the project are set at one-quarter, to reflect the



importance of complementary spending (such as teachers). Average primary school size in Malawi is 837 students, however, we're assuming just 280 pupils are added by each intervention, gradually over the first eight years of opening. Private returns are lagged by a total of three years – including a year after leaving school – while social returns are accounted during the year of education. All benefits are lagged by two years.

Smaller projects are likely to be more beneficial than wholly new schools, and the Wodadala et al (2019) paper described above presents some compelling evidence for the impact and cost-effectiveness of that choice, if it is made.

- **Health.** The methodology follows that used for a recent DFID business case in Malawi. It uses the disability adjusted life years identified in the 2018 York University work which supports the essential health package. It has been assumed that one-fifth of PBG spend would be on health facilities, and that spend would be 70 percent as efficient as EHP spending in terms of DALYS (disability-adjusted life years). Following the recent 2019 DFID business case, DALYs are valued at 15 percent of GDP per capita, which is a further conservative assumption.
- **Water and Sanitation.** Based on the literature on filtration of water supplies and estimates of catchment of each intervention from other countries, each water supply system would result in a 37 percent reduction in the incidence of diarrhea in the target community (there are 1.14 episodes per Malawian per year, all ages (Global Disease Burden, 2018)). Given the lack of evidence around latrines, a reduction of just 5 percent has been attributed to the receiving communities. DALYs are valued at 15 percent of GDP per capita.

In addition to health benefits, the time saved by piped water supply installation has been estimated at 2 hours per user, three times per week (a similar DFID project in Tanzania estimated 3.5 hours). Toilets are estimated to save 15 minutes once per day. Time value is valued at 4 US cents per hour. Clearly, this component depends critically on selection of areas with the least prior WASH coverage.

- **Performance improvement.** The dollar value declines by 5 percent a year for non-PBG development grants except for DDF; social value is just the spending value - this is probably an underestimate; and "leakage" from previously unfinished projects declines by 10 percentage points as a result of GESD. Other efficiencies - for instance, unit costs in Malawi are quite high on classrooms relative to richer countries in East Africa - result in a further 10 percent decrease. Spending, however, is low.
- **Other costs.** In addition to borrowing costs, costs of providing priority staffing levels relevant to DLI for 145 staff are estimated to be in the region of US\$700,000 - US\$1 million annualized¹. However, this is minimal relative to the level of benefits that might be expected, and the project returns a high benefit:cost ratio even where this is included in the analysis.

Maintenance costs are also included under other costs, despite the current situation, where little

¹ Assumes average total salary of US\$400 per month for these staff. Teaching and health staff are not calculated as induced costs, because only 25 percent of the additional school enrolment is ascribed to GESD, whereas health facility construction benefits is calculated based on the value from PBG



is spent on LAs' facilities maintenance. However, relative to benefits, maintenance at, say, 2.5 percent of installed value annually, assuming that 90 percent of the original PBG is spent on capital expenditure itself, would still result in a high, positive net present valuation.

8. **Non-quantifiable benefits.** The efficiency gains stemming from the institutional strengthening focus of the project are not easily quantified. In order to provide a fuller idea of the potential value of the Program, these benefits should be taken into consideration. These may include:

- **Spillover effects to other areas of spend.** The PBG is intended to spur better local government performance through the incentives generated by its links to the performance assessment, which should result in better performance management across LA spend. While this is valuable, it is difficult to find literature on local government fiscal multipliers; and more difficult to estimate a rate of return on every additional Kwacha of effective spend at the district level based on micro-econometric studies. Some attempt has been made to reflect the impact of the performance improvement on social returns in the quantitative analysis, however, this is likely to understate returns from the performance management improvements programmed.
- **Impacts on LA own-source revenue.** Having key staff in place is likely to improve the LAs' abilities to execute their revenue plans as appropriate to the individual authority's context and within the law. The performance assessment design proposes PMs focused on increasing locally raised revenue, which has induced significant real increases in revenue declared as part of LAs' budgets in Uganda (GoU, 2018, 2019).
- **Having key LA staff in place** is clearly likely to be beneficial for LA functionality. 145 staff are missing from the prioritized list of LA staff performing core functions (September 2019). However, the effect of additional management-level staff at the LA on quantifiable outcomes is difficult to separate from other benefits quantified.
- **The effects of improvements in grant design based on project experience as the project continues.** There is a lack of rigorous quantifiable literature on the impact of investment-based learning, so future improvements in design were not included in the quantitative analysis.
- **Linking planning (the AIPs) more closely with execution.** This is difficult to quantify, except by way of a secondary effect of better planning, for example higher overall execution. A reduction of unfinished projects has been quantified above.
- **Increasing confidence in local government systems.** The positive demonstration effect of GESD is envisaged to increase confidence in GoM local government systems by donor partners, potentially resulting in a "snowball effect" where an increasing amount of support is moved on-budget away parallel off-budget arrangements. This has not been modeled but has the potential to significantly increase the returns of the program.

9. **Value Summary.** The total net discounted cost of the loan is \$17.67 million. Other costs - hiring additional staff for the LAs to meet the minimum access conditions, and a 2.5 percent maintenance cost of expected PBG capital expenditures - total an additional \$17.4 million. The economic and social benefit from the major areas of spend identified total \$43.2 million in discounted terms, resulting in an internal rate of



return of 33 percent including all costs. This is large and robust to a number of scenarios regarding project delay, under-disbursement, or failure. Values are summarized in Table 3.4 and in the model snapshot in Figure 3.1, below.

Table 3.4: Economic Value Summary

Item	Discounted benefit, US\$ million
Costs of loan	-US\$17.6
Costs of maintenance and staffing	-US\$17.4
Education, private return, 730 schools	US\$5.3
Education, additional social return, 730 schools	US\$8.0
Health, 350 facilities	US\$19.4
Water and sanitation, 300 gravity-fed schemes and 900 latrines	US\$8.5
Performance improvement ²	US\$1.9 ³
<i>Other measures</i>	
Concept	Measure
NPV	8.2
Internal Rate of Return including all costs ⁴	33%
Benefits: costs ratio, excluding maintenance and staffing	2.4
Benefits: costs ratio, including fully funded maintenance and staffing ⁵	1.2

² Modelled gain from 10 percentage point reduction in unfinished projects and 10 percentage other efficiency improvements, on existing financing to LAs for other capital LA development grants for 7.5 years. DDF is assumed to stay constant in US\$ terms, while other grants decline by 5 percent a year. Potential efficiency gains on recurrent expenditure have not been modelled.

³ This figure is low due to the minimal amount of resources currently devoted to capital development spending through LAs.

⁴ IRR without maintenance costs is 84 percent - given the level of budgeting and maintenance practices, this is also a feasible scenario.

⁵ Provided separately – in practice, GoM and communities may not be able to finance 2.5 percent of infrastructure value per year in maintenance costs.



Figure 3.1: Economic Analysis Model Summary Snapshot

Year	0	1	2	3	4	5	6	7	8	9	10
FY	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
Assuming structure is 6 year grace and 32 year repayment. Zero date for discounting is effectively the 1st July 2020											
Costs											
Service charge and commitment	0.5	0.6	0.6	0.7	0.7	0.8	0.8	0.7	0.7	0.7	0.7
Discounted principal repayment, million								-1.4	-1.2	-1.1	-1.0
Discounted commitment and service	-0.5	-0.5	-0.5	-0.5	-0.4	-0.4	-0.4	-0.3	-0.3	-0.2	-0.2
Other costs of meeting DLI											
Total other costs, discounted	-0.2	-0.4	-1.0	-1.1	-1.2	-1.3	-1.3	-1.1	-1.0	-0.9	-0.8
145 staff at 400\$ per month, 2%	-0.2	-0.5	-0.9	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0	-1.1	-1.1
Maintenance costs - all new capital at 2.5% of \$70 million spend, 90% of PBG is capex			-0.3	-0.6	-0.9	-1.3	-1.6	-1.6	-1.6	-1.6	-1.6
Community construction costs											
Note annual repayment. This is a little rough.											
Benefit from education - new schools											
Private returns											
Unwaged income @2% growth		200	204	208	212	216	221	225	230	234	239
Job - primary @2% growth		341	348	355	362	369	376	384	391	399	407
Job - secondary @2% growth		477	487	496	506	516	527	537	548	559	570
Secondary (additional transitioning enrolment)											
Enrolment gains in existing secondary schools		four years of construction, 25% of schools each year									
		0	0	0	0	309	1,262	3,282	17,809	34,624	53,503
Quality gains from new infrastructure, secondary (primary to secondary premium up 1%)		0	0	0	0	35	143	373	2,024	3,935	6,080
Primary											
Primary (additional enrolment)		four years of construction, 25% of schools each year									
		two year lag		0	131,132	261,226	451,260	642,253	713,319	786,971	863,283
Quality gains, Primary (primary premium up 1%)				0	14,901	31,957	51,280	72,983	81,059	89,428	98,100
Discounted benefits, private		0	0	0	91,625	175,076	250,451	317,976	320,522	320,561	318,355
Social benefits, primary, discounted		0	0	177,790	329,529	457,889	565,328	533,355	502,473	472,751	444,239
Social benefits, secondary, discounted		0	0	0	0	1,267	3,535	6,565	10,161	12,622	14,108
Grand total education, discounted		0.0	0.0	0.2	0.4	0.6	0.8	0.9	0.8	0.8	0.8
efficiency improvements stemming from PDO 2 on non-PBG spend											
Additional value of DDF		lag	174,275	348,550	348,550	348,550	348,550	348,550	348,550	348,550	
Additional value of other AIP		lag	79,645	151,325	143,759	136,571	129,743	123,255	117,093	111,238	
Total discounted value			201,130	352,396	308,885	270,894	237,702	208,686	183,304	161,090	
Benefits, health											
Based on the York ERP analysis and assuming that spending on new facilities buys half as much as the mean ERP \$											
Total discounted				649,329	1,155,805	1,543,000	1,831,026	1,629,613	1,450,356	1,290,817	1,148,827
Water benefits (latrines and supply)											
Time saved (see Water sheet for assumptions)		lag	361,607	723,214	1,084,821	1,446,429	1,446,429	1,446,429	1,446,429	1,446,429	1,446,429
Health effects (see same sheet)		lag	33,710	67,419	101,129	134,838	134,838	134,838	134,838	134,838	134,838
Total discounted			313,130	557,372	744,032	882,989	785,860	699,416	622,480	554,007	493,066
All sectors											
IRR line all costs	-0.7	-0.9	-0.9	0.2	1.0	1.7	2.0	1.9	1.8	1.6	1.4
IRR line no maintenance costs	-0.5	-0.5	0.0	1.3	2.2	2.9	3.3	3.1	2.8	2.6	2.2

10. **Sensitivity Analysis.** The sensitivity analysis in Table 3.5 below estimates the sensitivity of the NPV and other measures of the project, to various project interventions not being carried out and various choices within the investment menu that might be taken by LAs which affect the total estimated return.



Table 3.5: Sensitivity Analysis

Description and brief explanation	Extent of risk, what can be done to mitigate it	Effect on return / expected value
Benefits reduced by 19 percent	Risk would only materialize if program was significantly delayed, and if a no-cost extension was not available. Discounted costs would decrease commensurately. Lags accounted for in all benefit estimates of 2 years after plausible construction times.	NPV remains positive.
Component underperformance Some LGs do not invest using the investment menu and choose zero-productive assets	<i>Low Risk.</i> Estimates of benefits are on the low side throughout the analysis ⁶	NPV Break-even if components are more than 19 percent underperformed. Alternatively, NPV is robust to a 28 percent discount rate. Excluding other GoM costs, loan is break-even at 59 percent underperformance.
A reduction in productive capital expenditure at central government level in response to increased PBG	<i>Medium Risk.</i> Disbursement condition included in legal agreement that PBG funds will only be disbursed when agreed budgeted amounts of DDF are released in full and on time.	No effect on calculated return.
Some LGs do not qualify for initial financing (other LGs would get more resources)	<i>Medium Risk.</i> Minimum access conditions are reasonable and LAs have been involved in performance improvement activities in preparation and early months of implementation.	Existing levels of financing and capital are so low that PBG can likely fund productive investments even if only a few districts benefit.
Lower return areas of investment from the investment menu are chosen by LGs	<i>Low Risk.</i> All areas assessed show significant rates of return.	Positive net return is still plausible on all proposed areas of intervention.

11. **Rationale for GoM investment.** Funding continues to severely lag behind the expanded functions that are being increasingly decentralized to LAs, thwarting confidence in local governance and service delivery systems. Given Malawi’s status as a very low-income country, there is unlikely to be a feasible private sector response that can provide a level of access to basic services which is socially optimal. Governments everywhere typically provide basic education and primary healthcare, particularly in contexts where many households do not participate in the cash economy. If Malawi is to capitalize on the momentum

⁶ Examples of conservative nature of benefit assumptions include: (i) 75 percent of attribution removed from intervention to account for GoM teachers’ provision expenses; (ii) Health: only 15 percent of GDP per capita used to calculate the value of disability-adjusted life years impacted by the project. Other evaluations have used 100-2072 percent of Malawi’s GNI per capita. (iii) Water and sanitation: conservative estimates for time value and for DALYs have been used relative to similar evaluations and the literature.



of increased decentralization, the moment is opportune to build on the progress of the last several years to strengthen national service delivery systems and coordination between central and local authorities.

12. **Rationale for World Bank support.** The World Bank has leading and unique expertise in this area, with a combination of global knowledge and technical skill in the design and implementation of local service delivery projects in Africa (for example, in Zambia, Kenya, Mozambique, Tanzania and Uganda). Moreover, the World Bank's convening power provides the opportunity to draw directly from experiences in similar context such as the proposed twinning arrangement with Uganda. The World Bank has the ability to administer projects as far as possible via government systems, at a time when many development partners in the post-Cashgate environment (2013) are more constrained or risk-averse in selecting a delivery mechanism.

13. **Design alternatives.** Two design alternatives are the options to either: (i) 'do nothing'; or (ii) execute the project through the central government as has historically been done. As it relates to doing nothing, it is likely that local government performance and service delivery would continue to deteriorate. Without LAs which are funded sufficiently to be functional, it is unclear that practice changes and learning stemming from other World Bank and Development Partner projects could be absorbed at the level of government which leads on service delivery of critical service areas for growth and poverty reduction. Also, central government execution would ignore the GoM's legal assignment of many basic service responsibilities. LAs serve to benefit from the principle of subsidiarity - decisions made at a level of government 'closer to the people'. LAs may be able to take advantage of: better project selection; lower costs; and higher community buy-in/co-financing, which is crucial given the very low level of government financial support to basic services in Malawi.

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