Overseas Development Institute

How, When and Why does Poverty get Budget Priority

Poverty Reduction Strategy and Public Expenditure in Malawi

Case Study 4

Adrian Fozzard and Chauncy simwaka

Working Paper 166

Results of ODI research presented in preliminary form for discussion and critical comment

Working Paper 166

How, When and Why does Poverty get Budget Priority?

Poverty Reduction Strategy and Public Expenditure in Malawi

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How, When and Why does Poverty get Budget Priority?
- about the research series

This is the synthesis paper of CAPE's research on *How, When and Why does Poverty get Budget Priority?* It is based upon the findings of five country case studies. The full list of research papers in this project is as follows

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Acronyms

ABB	Activity Based Budgeting
ADMARC	Agricultural Marketing Agency
AFORD	Alliance For Democracy
AGO	Auditor General's Office
BFC	Budget Finance Committee
CABS	Common Approach to Budget Support
CONGOMA	Council for Non-Governmental Organisations in Malawi
CSO	Civil Society Organisation
DANIDA	Danish International Development Agency
DDLGA	Department for District and Local Government Administration
DHRMD	Department of Human Resources Management and Development
ESAF	Enhanced Structural Adjustment Facility
GDP	Gross Domestic Product
GoM	Government of Malawi
HIPC	Heavily indebted poor country
IFPRI	International Food Policy Research Institute
IMF	International Monetary Fund
MAI	Ministry of Agriculture and Irrigation
MASAF	Malawi Social Action Fund
MASIP	Malawi Agricultural Sector Investment Plan
MCP	Malawi Congress Party
MEJN	Malawi Economic and Justice Network
MFEP	Ministry of Finance and Economic Planning
MoF	Ministry of Finance
MoHP	Ministry of Health and Population
MTEF	Medium Term Expenditure Framework
NDI	National Demographic Institute
NEC	National Economic Council
MoEST	Ministry of Education, Science and Technology.
NGO	Non Governmental Organisation
NSO	National Statistical Office
OPC	Office of President and Cabinet
PAC	Public Accounts Committee
PAP	Poverty Action Fund?
PAU	Poverty Alleviation Unit
PER	Public Expenditure Review
PPE	Priority Poverty Expenditures
PRSP	Poverty Reduction Strategy Paper
PSIP	Public Sector Investment Programme
UDF	United Democratic Front
UNCDF	United Nations Capital Development Fund

1 Introduction

1.1 Overview

This paper is one of five country case studies which seek to answer the questions how, when and why does poverty get budget priority? The paper assesses Malawi's experience in introducing pro-poor public expenditure policies from the 90s to 2001. Performance is assessed in terms of the consistency of fiscal policy and resource allocations with the Government's poverty reduction goals. The paper focuses on core financial management systems and the relationship between Ministry of Finance and spending agencies.

Chapters 1 to 3 assess the context within which pro-poor public expenditure management reforms have been implemented. The present Chapter provides an overview of the political economy of development during the 1990s. Chapter 2 examines poverty trends and the evolution of poverty policy. Chapter 3 assesses the impact of reforms intended to bring about a pro-poor, performance orientation in the public sector.

Chapters 4 to 7 assess the effectiveness of public expenditure management reforms. Chapter 4 presents data on aggregate public expenditure and resource allocation trends. Chapter 5 assesses reforms introduced by the Ministry of Finance and Economic Planning in the areas of expenditure control and resource allocation and their implications for decision-making and budget outturns at the agency level. Chapter 6 examines to what extent information is used to inform public expenditure decision-making. Chapter 7 assesses public expenditure governance, in terms of the transparency of public expenditure management systems, the effectiveness of legislative oversight and degree of public participation in decision-making. The paper concludes by identifying key policy implications of the assessment.

1.2 Economic developments in the 1990s

Malawi is a small, open economy heavily dependent on agriculture. In the late 1990s, agriculture generated around 40% of GDP and 90% of exports, with rain-fed maize accounting for about 25% of GDP and tobacco 65% of exports. The economy is susceptible to periodic climatic shocks, such as the droughts in 1992 and 1994 and the flooding during the 2000/2001 rainy season, which lead to significant reductions in agricultural output.

From Independence in 1964 to 1994 State intervention in the economy was pervasive. Malawi Chamber of Commerce estimates that three firms controlled 80% of the corporate sector. Two of these firms are parastatals, the third, the Press Corporation, a trust, was directly controlled by the President. Smallholder production of cash crops, notably tobacco, was prohibited, the prices of agricultural commodities were controlled, agricultural inputs were heavily subsidised and agricultural marketing was a virtual State monopoly. Government interventions favoured export-oriented agriculture and expansion of the estate sector, which grew to cover 40% of the arable land by the early 1990s. Rapid population growth exacerbated pressures on agricultural land, so that, by the mid-1990s, 40% of the 1.8 million smallholders cultivated plots of less than 0.5 ha. These policies contributed to a decline in GDP during the 1980s and effectively excluded the vast majority of the population from development.

The democratically elected Government in 1994 advocated a more participatory, liberal economic regime. Supported by the IMF, World Bank and donor community, it quickly set about dismantling State controls on the rural economy. By 1996, the Government had removed restrictions on

smallholder production, abolished the state marketing monopoly, liberalised prices on agricultural commodities and removed the state subsidy on fertilisers. Parallel reforms were introduced in other sectors, including liberalisation of the foreign-exchange market, reductions in export and import tariffs, and a privatisation programme, leading to the divestiture of some loss-making enterprises.

The IMF pointed to growth rates averaging 9.5% over 1995 and 1996 as evidence of a 'significant transformation' of the Malawian economy (IMF, 1997: 3). However, a large part of this increase in production can be attributed to the recovery from the droughts of 1994, when GDP dropped by about 12%. While it is true that liberalisation created opportunities for diversification of agricultural production, most farmers proved risk averse and maize continued to dominate production. The closure of 'un-economic' ADMARC markets restricted market access, since private traders failed to fill the gap in remote areas (Chilowa and Chirwa, 1997). Removal of the fertiliser subsidy in 1995 coincided with the flotation of the kwacha, leading to a 300 per cent increase in fertilizer prices and a decline in sales, with potentially serious consequences for yields and food security (Mwanza, 1999).

By 1996, there was growing concern regarding the efficacy of the IMF and World Bank sponsered adjustment policies. This was, in part, fostered by the secretive nature of the negotiations, which invovled few outside of the Ministry of Finance (Botchwey et al, 1998). The World Bank admits that the sequencing and timing of reforms amplified the adverse economic impact of measures such as the removal of fertilizer subsidy. It also recognises that it underestimated the adverse political reaction to some reforms (World Bank, 1998 and 200). Since 1997, the pace of reform has slowed and resistance to potentially unpopular measures has increased. For example, the Government has consistently and tactically refused to privatise the agricultural marketing agency, ADMARC, as advised by the World Bank and IMF. Surprisingly, the Government has also failed to address the issue of land reform, despite the poor performance of large estates relative to small farmers, evidence regarding the link between land access and poverty and the widespread political support this is likely to generate (IMF, 2001b).

Overall, economic performance during the 1990s was poor. Average per capita GDP growth from 1989 to 1999 was only 0.5%. Drought, deteriorating terms of trade – tobacco prices at the end of 1999 were 30% lower than in 1989 – and the impact of the HIV/AIDs pandemic have been important contributing factors. However, most commentators agree that the fundamental problem of the Malawi economy is macro-economic instability caused by Government's fiscal policies (Chilowa and Chirwa, 1997; Harrigan, 2001: IMF, 2001). Periodic surges in public spending, during the 1994 drought and in the run-up to the 1995 and 1999 elections, have led to unsustainable increases in the budget deficit, financed in large part by domestic borrowing and the printing of money, leading to surges in inflation and the crowding out of private sector credit (see Section 4.1). Inevitably, this has curtailed investment and discouraged savings. In this context, improvements in public sector financial management are seen as crucial to future economic growth and sustainable poverty reduction.

1.3 Political developments in the 1990s

Malawi's first multi-party elections in May 1994 marked an end to thirty years of authoritarian, single-party rule. Since then, considerable progress has been made in establishing the institutions of a liberal democracy: a new constitution was passed in 1995, providing for freedom of the press and freedom of information and establishing oversight bodies, including an Ombudsman and Human Rights and Electoral Commissions; civil society organisations and an independent press have emerged as vocal critics of government policy; and a second round of multi-party elections was held in 1999, followed by local government elections in 2000.

Eight political parties contested the May 1994 elections but only three emerged as contenders for government: the United Democratic Front (UDF), with its supporters concentrated in the south of the country, won the presidency and 93 seats in the 192 seat national assembly; the Malawi Congress Party (MCP), the party formerly led by Kamuzu Banda, with its powerbase in the central region, won 66 seats; and the Alliance For Democracy (AFORD), largely representing constituencies in the north, won 29 seats. In the absence of a clear parliamentary majority, an UDF/ AFORD coalition formed the first government. This collapsed in 1996, though UDF managed to retain a slim majority by the defection of six senior AFORD politicians who were members of the coalition cabinet. Both AFORD and MCP argued that defections were unconstitutional, since by-elections should have been held in the constituencies of the defecting MPs, and then briefly boycotted parliament in protest.

In the June 1999 elections, contested by twenty political parties, UDF was returned with a small majority of 93 seats, 97 including four independent candidates, against 95 seats for the opposition MCP-AFORD alliance. Both losing parties challenged the result on grounds of the unequal coverage offered by the state controlled media and delays in the distribution of ballot papers in MCP and AFORD dominated constituencies (Patel, 2000a). There were outbreaks of violence by MCP and AFORD supporters.

In the subsequent local elections, held in November 2000, which had a turnout of just 14% of registered voters, UDF won 610 of 860 wards and ended up controlling 33 of 39 assemblies, with AFORD controlling the remaining six assemblies in the north of the country. Since then, UDF has sought to drive a wedge between AFORD and MCP by introducing legislation banning inter-party alliances and trying to dismiss leading opposition MPs when they established a formal coalition in mid-2001. At the same time, the issue of a third term for the incumbent president remains unresolved.

There are some ideological differences between the leading parties. During the 1999 elections, for instance, UDF presented a liberal manifesto, balancing interests of government, people and private sector, while AFORD placed greater emphasis on workers' rights and the MCP was more conservative, stressing the importance of clean and efficient administration, peace and stability. However, political debate has tended to focus on a narrow range of governance and human rights issues, with all the parties presenting a similar developmental agenda, largely ignoring key issues such as national unity and land reform (Phiri, 2000). Besides, just as commentators feared before the break-up of the one-party state, distinctions between the parties' policies are obscured by the regional factions that have come to dominate Malawian politics.

Ethnic rivalries have been exacerbated by politicians seeking to strengthen their local power-bases and bolster personal support through patron-client relationships (Chirwa, 1998). In 1995 the UDF/AFORD coalition was accused of handing over funds for poverty alleviation to loyal MPs and it was claimed that the 'government has declared its intent to distribute state resources among its own constituencies' (Kaspin, 1995: 620). Subsequently, accusations of nepotism, regional favouritism and secessionism contributed to the break-up of the UDF-AFORD coalition the following year (Chirwa, 1998: 67).

Politicians have also sought broader support by advocating populist policies, promising free food, fertiliser, shoes, houses, bicycles and credit, thereby creating to high expectations among constituents (Lohmann, 1997; Harrigan, 2001: 334). Populism also played a part in the Government's decision to massively expand the free distribution of seeds and fertilisers through the Starter Pack Programme and announce a massive expansion of formal secondary schooling in the run-up to the 1999 elections.

A survey undertaken by Afrobarometer in 1999, revealed that most Malawians are aware of democracy and generally positive regarding its benefits. However, as Bratton and Mattes point out, ‘Malawians see democracy’s substance less in terms of socio-economic development than as a guarantee of political order and social harmony, which, given the country’s regional rivalries, may reflect wishful thinking’ (2001:12). Furthermore, the survey indicated that there is ‘more nostalgia for authoritarian rule than other countries’, with 22% agreeing with the statement that ‘in certain circumstances a non-democratic government can be preferable’. Unsurprisingly, these sentiments were strongest (30%) in Banda’s heartland, the central region. However, most Malawians gave democracy only a slightly higher performance rating than the old one-party regime.

Civil society organisations, particularly church-based organisations, played vocal part in the transition to democracy and the formulation of Malawi’s 1994 Constitution, ensuring that fundamental human rights were enshrined in law (Van Dorp, 1998; Chirwa, 2000). Once these goals had been achieved, civil society organisations were largely ‘relegated to the position of civic education providers’, taking a less active role in advocacy on governance and development issues (Chirwa, 2000: 93). This was partly because the organisations no longer had clear, consensual goals, but also because a number of the key players in the pro-democracy movement joined the government. Governance issues have gradually reasserted themselves, however, reflecting disquiet, particularly amongst church based organisations, at the frequent revelations of corruption and growing influence of regionalism and clientelism on politics. Poverty reduction is also increasingly prominent on the advocacy agenda, reflecting concerns at the failure of democratisation and continued economic reforms to bring about improvements in the quality of life for the majority of Malawians. The Catholic Church, for instance, issued a Lenten Letter critical of the progress of poverty reduction and the impact of economic policies on the poor in early 2001. Such criticism becomes more significant when one considers that the Lenten Letter of 1992 is widely accredited as having initiated the collapse of the Banda regime.

Malawi’s newspapers are closely linked to the rival political parties and are often highly critical of government. Cases of corruption are frequently reported in the press. There have been complaints that the government has used legislation dating back to the Banda era and intimidation to stifle critics (Freedom House, 1999 and 2000; US State Department, 2000). Nevertheless, ‘by and large the print media is refreshingly free’ (Patel, 2000: 169). This is less true of the radio, which reaches a wider audience in rural areas than newspapers. There are now four radio stations, two managed by Malawi Broadcasting Corporation and two independent channels, both owned by individuals with close connections to the UDF. The MBC in particular has been accused of bias in its reporting, especially during the run-up to the 1999 elections.

While the formal apparatus for governance in a multi-party democracy have been put in place, the democratisation process has been undermined by regionalist, coalition politics. Preoccupied with its short-term political survival, the government has employed authoritarian tactics against rivals, tried to bolster its position by satisfying the economic interests of supporters within the legislature and electoral constituencies, and resorted to populist policies.

2 Poverty and Poverty Reduction Policy

2.1 Poverty in Malawi

The results of the 1997/98 household survey indicate that about 60% of the population lives below the poverty line and 29% of the population is considered ultra-poor (NEC, 2000).[1] 91% of the poor live in rural areas, where the incidence of poverty is highest (see Table 1). There are regional differences in the incidence of poverty, with higher poverty and the ultra-poverty headcounts in the southern and northern regions, though these differences are not statistically significant. The distribution of consumption is extremely unequal: the poorest 20% account for 6.3% of total daily consumption while the richest 20% consume 46.8%. The survey also reveals the considerable depth of poverty, as indicated by poverty gap index, the ratio of the average extra consumption required to bring all poor people up to the poverty line. Extrapolating the poverty gap of the survey population to the national level, NEC estimates that the total poverty gap is MK8.75 billion, around 20% of GDP. Unfortunately, the 1991/92 and 1997/98 Household Surveys are not directly comparable, so it is not possible to draw definitive convulsions regarding trends in consumption poverty. However, there is little evidence to suggest that the incidence of consumption poverty has declined.

Table 1: Indices of consumption poverty, 1997

	Poverty headcount	Poverty gap	Ultrapoverty headcount	Mean daily consumption MK	Mean daily consumption US$
Southern Region	61.8	0.2535	31.8	11.94	0.47
Central Region	56.6	0.2118	25.3	12.35	0.49
Northern Region	61.5	0.2306	28.4	11.38	0.45
Rural	60.6	0.2385	29.3	11.30	0.44
Urban	50.8	0.1913	23.8	18.66	0.73
Malawi	**59.6**	**0.2336**	**28.7**	**12.05**	**0.47**

Source : NEC (2000) Tables 5, 6 and 7. April 1998 Exchange Rate MK25.40=$1.00.

Trends in indicators of other dimensions of poverty are mixed. One of the few areas where there has been a clear improvement is in education. Student numbers increased by 50% from 1994 to 1995, and gross enrolment rates jumped from 94% to 134%, following the introduction of Universal Primary Education. However, this increase in numbers has only been achieved at the cost of quality: the proportion of qualified teachers has dropped from 84% in 1993 to 50% in 1997 and repetition rates have increased sharply (Kadzamira and Rose, 2000). Moreover, the educational pyramid remains extremely narrow, with just 8% of the school population in secondary schools – as compared with 4% in the early 1990s – and secondary gross enrolment rates of just 16% (MoEST, 2000).

Female enrolment rates remain significantly lower than those for males and drop-out rates are significantly higher. Census data reveals that literacy rates for males increased from 52% in 1987 to 64% in 1998, with rates for females rising even faster from 32% to 51% over the same period

[1] The poverty line has been determined using a cost-of-basic-needs approach, reflecting the costs for poorer households to aquire sufficient calories to meet recomended calorie requirements and to meet non-food requirements, calculated on the basis of the non-food consumption of the those households whose total consumption is within 20% of the food poverty line. In July 2000 prices, the rural poverty lines are between MK14.42 and MK20.74 per day and the urban poverty line MK47.18 per day. The ultrapoverty line was set at 60% of the poverty line. The incidence of poverty was calculated on the basis of a sub-set of 6,586 of the original 12,960 survey households with reliable expedniture and consumption data. Categorizing households as poor and non-poor using the total consumption values for the 6,586 households and proxy welfare measures for the 4,112 dropped households results in a poverty headcount of 65.3% as compared with 59.6% using the consumption of the 6,586 households alone.

(NSO, 2000). However, rural-urban differences in literacy are still marked (54% and 79% respectively), and literacy rates are higher in the north than they are in the south. The proportion of men and women never having attended school has dropped from 1992 to 2000, from 21% to 10% for men, and 47% to 27% for women; and the proportions reaching higher grades is also increasing (NSO and Macro, 2000). However, educational attainment remains weak: 88% of the population of school age and above have no academic certificate, only 6% have a primary leaving certificate and 2% Malawi School Certificate of Education (NSO, 2000).

Most health indicators are stable or deteriorating. Comparison of health and population surveys reveals that rates of child malnutrition and consequent stunting and wasting have not changed since 1992, with about half of all children under five being too short for their age, and half of these severely stunted, while 6% are wasted (too light for height) and 1% severely wasted. Children in rural areas are more than twice as likely to suffer from stunting as those in urban areas. Coverage of vaccination programmes seems to have slipped since 1992; 82% of children were fully vaccinated in 1992, but only 70% in 2000. Survey results also point to significant regional differences in vaccination coverage – 78% in the north compared to 61% in the centre. Against this backdrop, it is somewhat surprising that infant and child mortality rates have fallen slightly during the 1990s, though at 104 and 189 per thousand, these rates are still significantly higher than the average for sub-Saharan Africa (NSO and Macro, 2000).

Increased contraceptive use, with a consequent reduction in fertility rates and improved spacing, may have contributed to this trend. In 2000, 26% of women used modern contraceptive methods as compared with just 7% in 1992, with 68% of users taking contraceptives from government clinics. Maternal mortality rates, on the other hand, appear to be rising, from 620 per hundred thousand in the 1986-2000 period, to 1,120 from 1994-2000, even though the use of antenatal services remains high, at around 90% in 1992 and 2000, as does the proportion of births in health facilities, at 55% (NSO and Macro, 2001). Life expectancy has also has fallen significantly during the 1990s, from 47 years to 43 in 1997. This is largely owing to the impact of AIDS. The Government estimated that, in 1999, nearly 16% of the population was HIV positive, amounting to 800,000 people, and that there were already 300,000 AIDS orphans (GoM, 2000).

Living conditions show some evidence of improvement. The proportion of the population with access to safe water has increased from 47% in 1992 to 67% in 2000, and to sanitation facilities from 72% to 81% over the same period (NSO-UNICEF, 2001). Most of the population lives in traditional housing, only 4% use electricity for lighting and only half have access to a radio (NSO, 2000). Anecdotal evidence suggests that levels of criminality are on the rise, particularly in urban areas. This is partly because the security apparatus of the Banda regime was dismantled without putting in place an extensive police force. In 1999, there were 6,000 policemen in a population of ten million. A survey of businessmen undertaken in 1996, put crime and theft second only to weak infrastructure as major obstacles to private business (World Bank, 1998).

2.2 The evolution of poverty policy and planning

Under Banda the goal of development policy was to increase national income through the promotion of investment in industry and commercial, export-oriented agriculture. Customary land was converted to leasehold estates in order to expand tobacco production. The number of estates increased from 1,200 in 1979 to 14,671 in 1989, leading to the emergence of a class of poor tenant farmers and a reduction in the acreage available to small-holders (Harrigan, 2000). Rapid population growth exacerbated pressures on agricultural land. Nevertheless, the Government pursued pro-naturalist policies, limiting access to contraception. Spending on health and education was geared to increasing the productivity of labour and meeting the needs of the modern sector

rather than the basic needs of the population (Kishindo, 1997). Education spending was skewed towards the provision of heavily subsidised secondary and tertiary education to provide skilled manpower and opportunities for the elite. Health spending was similarly skewed towards the provision of tertiary care, primarily in urban areas. The official view was that poverty was not widespread in Malawi and isolated cases were a result of an attitudinal problem; poverty could be eliminated through hard work and did not require specific government interventions. Those that disagreed were considered unpatriotic (Chilowa and Chirwa, 1997). There was also a regional dimension to the government's development policies, with the central region – MCP's political heartland – clearly favoured over the north and south of the country.

In contrast, the democratically elected Government gave priority to poverty reduction from the start. One of its first policy measures was to abolish fees on primary education, accelerating the phased reduction begun in 1991. A National Population Policy was announced in 1994, providing for state sponsored distribution of contraceptives to meet unmet demand. This was followed, in 1995, by a Policy Framework for Poverty Reduction with four key objectives; to raise the productivity of the poor; to promote sustainable poverty reduction; enhance the participation of the poor in development; and increase income and employment opportunities for the poor. A Poverty Alleviation Unit was established within the National Economic Council to ensure that these objectives were reflected in sectoral policies and programmes and coordinate the Government's Poverty Alleviation Programme. Policy orientation was to be provided through a Presidential Council on Poverty Alleviation, while a Coordinating Committee was established including representatives of line Ministries and NGOs to oversee the work of the PAU.

Under PAP, priority was given to the reorientation of spending towards services used by the poor, notably primary education and health care, and rural infrastructure (see Section 4.2). At the same time, the Government introduced a number of flagship poverty reduction programmes. Prominent amongst these was the World Bank financed Malawi Social Action Fund, established in 1995 as a means of empowering and channelling funds directly to community self-help initiatives, such as boreholes, school blocks, clinics, roads and bridges, dams and reforestation schemes (Schroeder, 2000). Safety nets were expanded, through programmes for vulnerable group feeding, labour-intensive public works and, in 1998, a Starter Pack Distribution Programme, providing small-holders with 20kg sacks of seed and fertiliser (Phiri, 2000).

These measures led to a significant increase in the flow of resources to poverty reduction activities and ensured that PAP had a high profile. However, the poverty strategy was not without its critics. Kalemba (1997) has argued that the PAP failed to differentiate priority groups within the poor, leading to broad programmes rather than targeted interventions likely to meet the needs of the poorest groups. As a result, PAP overstretched the government's financing capacity and reduced the programmes' poverty reduction impact. Political considerations are also likely to have contributed to the Government's preference for broad, untargeted interventions – such as the Starter Pack Programme – since these were more likely to translate into wide electoral support. Kalemba points out that the strategy was conceived as a package of sectoral programmes implemented through central ministries, handicapping inter-sectoral coordination and leading to inadequate prioritisation. Most programmes were designed top-down, providing few opportunities for local participation (Devereux and Cook, 2000). Even MASAF, which sought to respond to community identified priorities, had a centralised project approval process, through a Steering Committee in Lilongwe, and channelled funds direct to communities from a quasi-autonomous MASAF Management Unit, thereby bypassing local authorities (World Bank 1998c; Schroeder, 2000).

In contrast to the technocratic approach to poverty planning followed in preparation of the PAP, preparation of the Vision 2020 document was much more participatory exercise. Vision 2020 was intended as a consensus document and was prepared by a core team including representatives of

government, business, academia, political parties, labour unions, and churches. Consultations took place through national workshops and expert meetings during 1996 and 1997. The resulting document was much broader in its scope than the PAP (NEC, 1998). Nine priority areas were identified: good governance; fair and equitable distribution of income; food security; science and technology; vibrant culture; economic infrastructure; sustainable economic growth; sustainable environmental management; and human resources development. Although Vision 2020 presented extremely ambitious targets for the distant future – such as for Malawi to achieve a per capita income of $1,000 by the year 2020 – and had no clear linkage to operational planning, it marked an important step forward in terms of the nature of the planning process, by promoting participation, and in considering the close linkages between poverty, governance and economic growth. However, Vision 2020 also reveals that many of the attitudes and aspirations of the Banda regime remain intact. Achievement of the developmental goals, for instance, requires Malawians to reverse their 'negative attitudes' towards work and governance, while industrialisation is still seen as the key to development, with ambitious targets for the growth in manufacturing from 12% to 25% GDP over the twenty year period.

2.3 The PRSP process

The Government began work on its Poverty Reduction Paper in May 2000, primarily in order to comply with IMF and World Bank financing requirements and the timetable for HIPC funding (see Section 4.3). Owing to the limited time available, the Government did not prepare a full Interim-PRSP. Instead, in August 2000, it submitted a 'PRSP Road Map'. This outlined the Government's broad approach to poverty reduction, which, building on the PAP and Vision 2020 documents, identified three key areas of intervention: promotion of smallholder agriculture, to raise the productivity and income of the poor; promotion of private-sector growth to expand off-farm employment; and expansion of social services (GOM, 2000).

The Road Map laid out the timetable and mechanisms for the preparation of a full PRSP document. This envisaged a National Symposium in February 2001 and Cabinet approval of the PRSP in March, leaving only five months for consultations with Civil Society Organisations, the private sector and donors. Significantly, the timetable did not envisage parliamentary approval of the PRSP. A Ministerial Committee was established, chaired by the Minister of Finance and Economic Planning, including the Governor of the Reserve Bank, the Directorate General of the National Economic Council and the Ministers of Education, Health, Agriculture and Public Works. This was to be supported by a Committee of Principal Secretaries, again chaired by Treasury (MFEP), and a Technical Committee chaired by NEC, with participants from Treasury and the Reserve Bank.

Technical work on the preparation of the PRSP only got under way in January 2001, when the Government held a launch seminar and constituted nineteen thematic groups to draw up costed implementation strategies on sectoral and cross-cutting issues, such as finance, decentralisation, HIV/AIDs, gender and empowerment, poverty monitoring, security, and environment. Consultations have been held at the national level and through half-day district meetings. However, most of the policy work has been undertaken by thematic groups, comprising representatives of central government institutions, donors and civil society organisations.

Preliminary conclusions were presented in the 'PRSP: Findings to Date', drafted by the PRSP Technical Committee in May 2001. This document was intended as guidance for preparation of the 2001/02 budget (PRSP-TC, 2001: see Section 4.3). Reflecting contributions from district meetings, the 'Findings to Date' identified three overall priorities: macro-stability, which was considered the highest priority 'almost unanimously'; tackling corruption and fraud; and decentralisation. The document also outlined policies and strategies for the key sectors, distinguishing policy and

expenditure measures, including proposals for: shifts in the orientation of spending in the agricultural sector toward the removal of 'barriers that poor farmers face to increased income and food security from higher agricultural production', by promoting off farm activities, access to markets, and 'reversing the decline of the extension system'; the reallocation of resources to primary education and teacher training, while increasing cost recovery in secondary schools and making tertiary education financially independent; the design and implementation of an Essential Health Care Package, based on a minimum bundle of services, rather than around vertical programmes; and increased spending on water supply and sanitation. In order to ensure that resources were reallocated towards priorities, the 'Findings to Date' recommended the designation of thirteen 'poverty priority expenditures', which would be constituted as a virtual poverty fund – much the same as Uganda's Poverty Action Fund – so as to be easily tracked and protected from in year cuts.

The rushed timetable, the secretive negotiations between Government and IMF/World Bank and the lack of opportunity for comprehensive consultation were criticised from the start. Much of this criticism originated in the small but vocal Malawi Economic Justice Network, established by church groups and supported by a consortium of internal NGOs. MEJN ridiculed the original PRSP timetable, forcing the Government to push the deadline for the presentation of the PRSP back to January 2002, in order to allow more time for consultations. MEJN criticised the lack of opportunities for civil society participation in the planning process – pointing out that there were only 8 civil society organisation representatives and 5 MPs amongst the 159 participants at the PRSP launch workshop, and lobbying successfully, for the participation of more CSO representatives in the thematic groups and drafting team. In an overview of the PRSP process, MEJN criticised the quality of the thematic groups' work, particularly as regards the lack of expenditure limits to guide the prioritisation of interventions and failure to address cross-cutting issues at the sectoral level (Magalasi et al, 2001). Subsequently, MEJN argued that the CSOs should be allowed to undertake independent reviews of the thematic groups' final presentations. From MEJN's perspective, at least, the Government has been reluctant to engage in meaningful consultation, let along participation, in the poverty planning process.

It is, as yet, difficult to assess the impact of the PRSP process on Government policy. The 2001/02 Budget Speech made extensive reference to the PRSP and revealed increases in the allocations for some of the priority PRSP sectors and activities. However, the MFEP has not yet implemented the 'Findings to Date' document's central recommendation: discrimination of priority poverty expenditures within the budget. Furthermore, the Budget Speech reveals a continued preference for formal sector, manufacturing industry as the basis for development – indicating that the Government intends to provide seed money to suitable industries – and a belief that poverty is, in large measure, an attitudinal problem (MFEP, 2001). The weak linkage between poverty planning and the 2001/02 budget bodes ill for the future integration of these processes. There is certainly a risk that the PRSP will, like the Vision 2020, serve principally as a reference document, rather than a guide for operational planning and decision making.

3 The Institutional Framework

3.1 Public sector reform

In the closing years of the Banda regime the public sector was characterised by a multiplication of institutions and departments with overlapping responsibilities, lack of performance related information and weak financial management (World Bank, 1994). Decision-making within the public sector was extremely centralised. The President himself intervened in key policy decisions, undermining collegial decision-making, and the Office of the President and Cabinet assumed responsibility for a wide range of operational functions. Within individual departments too, senior managers often intervened in operational decisions, sometimes down to the field level. Over a period of twenty years, most local government's functional responsibilities had been transferred to central government. Moreover, the boundaries of public sector were blurred owing to pervasive regulations and the large number of public institutions, including 132 enterprises, 38 statutory bodies, 3 companies wholly or partly owned by statutory bodies, and 54 independently managed Treasury Funds.

Management problems were compounded during the transition to democratic rule. The new regime's attempts to de-link the MCP from the state revealed 'profound disagreements between politicians and officials on the definition of their respective roles and on what loyalty and professionalism should mean in a career civil service' (Adamolekum et al, 1999: 216). Strained relations between politicians and long-time civil servants hampered the implementation of the new government's programme (World Bank, 1998: 8). Many senior civil servants retired and officials considered loyal to new regime were promoted to serve as joint heads of some departments, leading to inconsistent administrative leadership and perpetuating the practice of political interference in civil service appointments.

Political considerations and international pressures, from the IMF and the World Bank in particular, favoured a radical overhaul of the public sector immediately after the transition to democracy. No formal, comprehensive public sector reform strategy was prepared. Instead, the Government proceeded simultaneously on five fronts:

- rationalisation of institutional mandates and their realignment with policy objectives, following the recommendations of a rolling programme of functional reviews;
- improvements in governance and public sector ethics, by establishing an Anti-Corruption Bureau with oversight and investigative powers;
- improvements in civil service performance, through reforms in personnel management and public sector pay;
- decentralisation of service delivery and development management functions, through the creation of representative local government in rural areas;
- strengthening public expenditure management, focusing on improvements in resource allocation and expenditure control.

This chapter assesses the first four of these reform initiatives in terms of their implications for on poverty reduction orientation and the impact of public spending. Reforms in public sector financial management are assessed in Chapter 4.

While progress has been made, the impact on public sector performance has so far been limited. This is partly because the Government has been slow in implementing those reforms that carry political risks or challenge vested interests within the public sector, such as the decentralisation programme and retrenchment of civil servants. More importantly, 'no champion for reform has

emerged' resulting in 'a rather unfocused and uncoordinated approach to both the formulation and implementation of reform measures' (Adamolekum et al, 1999: 220). A Cabinet Committee on Civil Service and Public Sector Reform has overseen the implementation of the the functional reviews, the Department of Human Resources Management and Development has taken the lead on civil service reform, the Department of Local Government on decentralisation, and the Ministry of Finance on public expenditure management reforms, while the line Ministries have implemented reforms within the framework of their sectoral programmes. There is no overarching strategy or institutional mechanism for bringing these disparate reforms together or realising synergies between them. Coordination has been further complicated by the multiplication of donor financed reform 'projects', sometimes offering duplicate assistance and contradictory advice, and often overwhelming local leadership capacity. While the Government is aware of these problems and is now strengthening the OPC as leader of the reform process (GoM, 2000), it is still unclear whether the OPC will have sufficient authority to coordinate sectoral reforms at a strategic, let alone an operational, level.

3.2 Rationalising central government

The World Bank's Public Sector Management Review argued that the public sector was over-extended, undertaking a wide range of functions on paper but without the human and financial resources to implement these functions effectively. It recommended that the role of Government should be reassessed, the institutional structure rationalised and the mandates of public institutions realigned with core competencies and capacity (World Bank, 1994).

In 1996/97, the OPC undertook a strategic review of the public sector, which led to a reduction in the number of ministries from 27 to 19 – rather than a rationalisation of the functions of government – and recommended the outsourcing of support functions, such as security, cleaning and office equipment maintenance throughout the civil service. This was followed up, in 1997, with the creation of a Management Change Unit, reporting to the Cabinet Committee on Civil Service and Public Sector Reform, and the implementation of detailed functional reviews of all central government departments and ministries. These were supposed to identify agencies' core and peripheral functions, and the appropriate institutional structure and staffing levels needed to deliver core services.

In practice, most of the functional reviews took the existing institutional mandate as a starting point and so failed to reassess the Government's role in each sector, largely ignoring the potential for enhanced private sector participation in service delivery. This was partly because the review process lacked a clear, guiding vision of the role of the State at a political level. However, the review process also suffered from technical limitations. In the absence of a firm resource constraint – the reviews were undertaken outside the on-going MTEF process, which failed to set medium-term resource limits anyway – reviewers had no basis for assessing sustainable levels of service delivery and or arguing for fundamental changes in institutional mandates. Furthermore, most of the technicians undertaking the reviews were drawn from the civil service itself, especially DHRMD, and so had little understanding of the potential for private-sector partnerships.

Some cost savings were identified, largely through reductions in support staff and contracting out of support functions. In most cases, however, savings were more than off set by proposed increases in the number of professional grades, justified on grounds of the need to meet the institution's broad developmental and service delivery mandate. Consequently, as a tool for realigning the State in line with financing and human resource capacity, the functional reviews had little impact. Even though the reviews did help reorganise Ministries, notably by strengthening planning functions in the 'developmental ministries' (education, health, agriculture and natural resources), eliminating

functional duplication and identifying improvements in information and management systems, most were completed before the decentralisation policy was announced, and so have not taken its implications for the role of central Ministries and Departments into account. The implications of decentralisation are profound, entailing a progressive decentralisation of service-delivery functions in key sectors, leaving the central ministries with policy, regulatory and supervisory functions.

3.3 Improving civil service performance

The World Bank's Public Sector Management Review reported a 'virtual collapse of the control system for [civil service] recruitment, promotions, transfer, secondments and training' in the closing years of the Banda regime (World Bank 1995: 22). Lower grades within the administration were heavily overstaffed, while there were 30% shortfalls on professional and senior managerial grades. Differentials between public and private sector pay widened significantly, contributing to poor motivation, difficulties in recruiting appropriately skilled staff and provoking civil service strikes in 1993.

In 1995, the Government launched a civil service reform programme aimed at improving productivity and performance by retrenching superfluous lower-level staff, gradually increasing pay to competitive levels and introducing performance management systems, while, at the same time, releasing a increasing proportion of resources for service delivery. These components of civil service reform were closely related, since there was little prospect of improving civil service pay and increasing spending on service delivery without reducing staff numbers.

A Civil Service Census was implemented in order to regularise payroll and personnel registers, thereby identifying ghost workers and unauthorised appointments. This led to the retrenchment of 14,000 industrial grade workers (mainly temporary employees) in early 1996. The Census was followed up by a job evaluation exercise, which was supposed to re-grade posts and identify further areas for retrenchment. After the initial round of retrenchments, however, progress has been slow, with net increases in the number of civil servants each year. Recruitment of primary school teachers accounted for most of this increase. However, subsequent civil service head counts have revealed that controls on recruitment are still weak; a 1998 survey, for instance, identified 111,858 civil servants, of whom 21,964 (17%) occupied unauthorised posts, while 5,107 (4%) were either ghost workers or had dubious qualifications (DHRMD, 1998). A computerised personnel management system, which should enable tighter controls on payroll, was scheduled for 1999 but is still not finalised. Inevitably, the Government's failure to bring personnel under control has severely restricted the scope for pay reform.

A Commission of Inquiry into the Civil Service Conditions of Service in 1995, recommended significant increases in public sector pay. Across-the-board pay increases followed in 1996, together with significant decompression, in order to raise pay in senior grades and so facilitate recruitment of qualified personnel. The 1997 pay round channelled most of the additional resources into decompression, leading to a six-week public sector strike when pay increases for lower grades were lower than the average levels announced by Government. Most subsequent pay rounds have limited compression in favour of across-the-board pay rises, thereby allowing slightly higher pay awards at the lower end of the pay scale. Salaries remain extremely low throughout the civil service, and least competitive in the middle and senior grades. In 2000 the starting salary for a trained primary school teacher was only MK1, 042 (US$25) per month, a secondary school teacher holding a university degree MK2, 280 (US$51) and a university lecturer holding a second degree MK5, 633 (US$155). Low levels of pay have led to continuing problems with recruitment, created a range of perverse incentives, such as the diversion of a substantial part of agencies' budgets to

travel so that employees can benefit from allowances, and the emergence of gate-keeping behaviour in schools, hospitals and other government institutions.

Some attempt has been made to introduce a performance dimension to personnel management. In 2000, civil servants at Deputy PS level and above were given the option of signing three-year contracts, with monetised benefits, leading to a tripling of base salaries, or remaining within of government pay scales. Three quarters of eligible staff opted for contracts. In principle, continued employment is conditional on the achievement of performance targets, with performance assessed by Ministers and the OPC. The effectiveness of these arrangements can be questioned, since performance targets are vaguely couched, senior staff are at the end of their careers, and so are unlikely to have resigned in search of higher levels of pay, and their performance is dependent on lower level staff anyway. As yet there is little prospect of the performance contracts being extended lower down the hierarchy, to the field level where they might have a direct impact on service delivery.

3.4 Improving governance

Creation of a clean, transparent public sector, working in the public interest, was central to the pro-democracy movement's reform agenda. Article 37 of the 1994 Constitution guarantees individuals access to all information held by the State necessary for full exercise of their fundamental rights. The Constitution also established three constitutionally mandated oversight bodies: the Anti-Corruption Bureau, the Ombudsman and the Human Rights Commission.

However, in the absence of enabling legislation, freedom of information is still limited by restrictions on access to public records on grounds of security, the persistence of a culture of secrecy in some branches of the public service and the susceptibility of public institutions to political intervention. Furthermore, the effectiveness of the oversight bodies is constrained by lack of adequate funding and staff. The Anti Corruption Bureau, for instance, can only investigate a handful of the 3,000 complaints it receives each year, most of which relate to secondary school placements, but also covering the police and customs services and many other government departments. The Ombudsman's freedom of action is further circumscribed by legislation that requires a warrant and a 3-day waiting period to gain access to certain government records (US State Department, 2000). Nor are the oversight bodies immune to political interference: in August 1999, Malawi Broadcasting Corporation secured a High Court injunction, from a judge who was later forced to resign as chair of the Electoral Commission for his biased role, preventing the Ombudsman from investigating the dismissal of four of its employees (Patel, 2000: 173). Consequently, while the Government upholds the principle of freedom of information, in practice this right cannot easily be exercised by the majority of the population and the principle may only be upheld selectively.

The HIPC Decision Point document makes much of 'weaknesses in governance' and 'recent cases of fraud, corruption and the misappropriation of public funds' (IMF and World Bank, 2000: 100). It cites an October 2000 report by the Account General, submitted to the National Assembly's Public Accounts Committee, giving evidence of fraudulent contracting in the Ministry of Education, implicating Ministers, MPs and senior civil servants. Other publicised cases have involved the Electoral Commission, Petrol Control Commission, customs, and contracts for the supply of vehicles and identity cards. In all of these cases the Government has, eventually, dismissed those held responsible – three ministers were dropped from Cabinet over the Ministry of Education case – but prosecutions have been slow to follow. The Director of Public Prosecutions has argued that there is insufficient evidence to bring cases to trial, though donors and some sections of the press clearly believe that the delays are politically motivated. In response, the IMF has insisted that the

authorities increase spending on oversight bodies and give 'firm commitments that, in future, all evidence of offences uncovered by the AG and other public investigating officers will be speedily pursued' (IMF, 2001b: 26).

Concerns have also been raised about politicians' awarding themselves generous pay and benefits. In 1996, Ministers received a pay rise at more than double the level for civil servants. The most blatant cases, however, relate to the purchase of vehicles. In late 1999, the government borrowed $4 million on behalf of members of parliament to purchase vehicles, allowing MPs to repay in kwacha at an interest rate of 10% and with an exchange rate risk assumed by government. A second case arose in 2000, when the Government placed an order for 39 Mercedes Benz's to replace the fleet purchased 1995-97. In response to criticism in the local and international press, and adverse comment from the British High Commissioner amongst others, the President gave orders for the ministers' vehicles to be sold. These cases have, inevitably, fostered cynicism regarding politicians' motives.

For most Malawians, however, lower-level corruption and fraud is a more immediate problem. MFEP (2001) estimates that about 60% of drugs are diverted from the public health system, so that drugs are simply not available for patients in most Government health clinics and hospitals. Similar problems are found in the distribution of school materials. Attempts are being made to reorganise the management of medical stores to reduce losses. The Central Medical Stores is to be restructured as a semi-autonomous body and clinics are to establish drugs revolving funds (GoM 2000a). Public services also suffer from problems of staff abseteeism, gate-keeping and informal privatisation. Payments for additional tuition by teachers, for instance, are common. Most of the cases of corruption reported to the Anti-Corruption Bureau and the Ombudsman relate to the education system, with the majority concerning the award of scarce places in the public secondary schools.

It is questionable whether these problems can be addressed through improved management systems alone. Local level transparency and accountability is needed too. While both health facilities and schools have local community committees, these institutions are not legislated and have no real authority over the civil servants delivering services. While the PAP and PRSP have stressed the importance of local level empowermment, this has generally been seen as a mechanism for raising local cash and in-kind contributions for the construction of infrastructure, rather than control over service management. Although the decentralisation process will eventually establish formal accountability mechanisms at the district level, this is still distant from the field (the average district has a population exceeding 250,000). Below the district level, accountability mechanisms will continue to rely on traditional authorities and party structures. Consequently, it is unclear whether the decentralisation process will create more effective mechanisms for local control over service delivery units.

3.5 Decentralisation

Under the Banda regime, government was gradually centralised by stripping District and Municipal Councils of their functional responsibilities and revenue base, 'ostensibly for the purpose of maintaining national unity and cohesion' (Kaunda, 1999). Legislatures and members of local authorities were vetted by and subordinate to the MCP and were required to implement policies determined by central government. District Commissioners, appointed by the Office of the President to advise local councils, had extensive oversight powers and executive responsibility as chairs of the District Development Committee. Lower-level Area and Village Action Committees were basically extensions of the party machinery (Geist and Ng'ethe, 1998).

For the pro-democracy movement, decentralisation was both a political expedient, breaking up the one-party state, and a means of bringing government closer to the people. The 1994 Constitution provided for elected local authorities with responsibility for infrastructural and economic development, through formulation and execution of local development plans and the encouragement of business enterprise, the promotion of democratic participation, and the promotion of local issues to national government. However, the Constitution failed to specify local authorities' functional responsibilities or provide a timetable for implementation.

Some changes on the ground followed. The District Development Committee was restructured, to include MPs, chiefs, chairpersons of local authorities, chairs of political parties and two NGO representatives, though its responsibilities were still limited to planning, co-ordination and the approval of micro-projects. A UNCDF pilot programme was established, supporting participatory planning and decentralised financing of small-scale projects through small discretionary block-grants. However, these measures merely served to reinforce the role of the centrally appointed District Commissioner. District councils ceased to function effectively, since their electoral mandates gradually elapsed. New elections were programmed in 1997, but were postponed, owing to lack of funds (though it has been claimed that the Government feared that local elections would deliver local authorities into the hands of the opposition (Kaunda, 1999: 593)).

The Government eventually approved a decentralisation policy in late 1998, followed by a Local Government Act. These provide for assemblies in the twenty-eight districts and five municipalities, with traditional leaders and five appointed ex-officio members, a single administrative secretariat reporting directly to the assembly and a unified local authority budget. Broad functional responsibilities are defined, including: education (primary and part of secondary); health (health centres and public health); environmental services; local roads; small and medium business licensing; fisheries, forestry and agriculture; water; community development; and community police. Service delivery functions are gradually to be transferred to local authorities, with central government providing support, policy guidance and setting and enforcing standards. Local revenues are identified, including property rates, ground rent and fees, supplemented by a central block grant amounting to 5% of national revenue (though exemptions significantly reduce the actual share), with additional funds to be made available in order to finance the gradual transfer of service delivery functions. While the authorities are granted financial and administrative autonomy, financial management procedures are to be defined in regulations framed by central government and their budgets approved by an appointed body, the Local Government Finance Committee, established under the 1994 Constitution.

Implementation of these reforms is seen as a ten-year programme. Following the local elections in November 2000, priority has been given to training local councillors and the design and implementation of financial management systems, including supporting software. Functional responsibilities have yet to be transferred, with the authorities continuing to focus on administration, local development planning and small-scale public works. Sectoral ministries are now beginning to prepare strategies for the transfer of service delivery functions. However, the education and health sector strategies suggest that the full transfer of responsibilities is unlikely to start before 2004 (MoHP, 1999; MoEST, 2000). Studies of tax and transfer mechanisms have also been commissioned (for example, Boex et al, 2001). In the meantime, local authorities have received slightly increased levels of core funding from central government, though it is anticipated that core funding will only reach the 5% of revenues foreseen in the law after three years (DDLGA, 2000). Some funds have been made available for development projects, with additional financing from UNCDF, ADB and DANIDA. Consequently, local authorities still have narrowly defined functional responsibilities and limited funding.

Decentralisation offers considerable potential for improving public sector service delivery and strengthening local participation and governance. As yet, however, it is impossible to assess to what extent this potential can be realised. Much depends on the Government's continued commitment to reform. The creation of a Cabinet Committee on Decentralisation, supported by a Decentralisation Secretariat (currently staffed by personnel from UNCDF's District Development Fund programme), may be seen as a signal that the Government intends to pursue the reform programme. However, the real test of the Government's resolve will arise when it has to reallocate resources from central ministries to local authorities in order to support the decentralisation of service delivery management.

4 Public Expenditure Trends

4.1 Aggregate spending

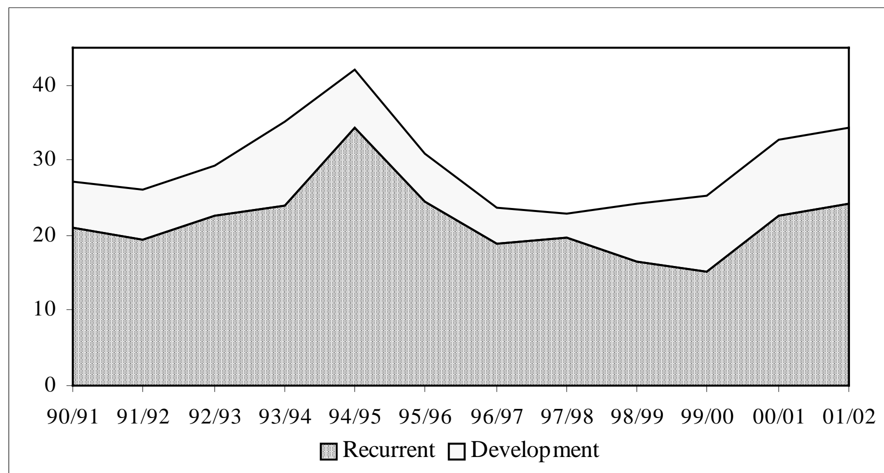
Malawi has suffered from chronic budgetary instability throughout the 1980s and 1990s. This stems in part from the economy's susceptibility to climatic shocks, which temporarily reduce revenues and require additional spending on emergency relief and rehabilitation, as occurred during droughts in 1992 and 1994, and floods in 2000. However, the principal causes of budgetary instability have been political and institutional rather than environmental. Since the 1980's Malawi's fiscal policy has been characterised by periods of fiscal expansion, with burgeoning deficits financed by internal borrowing and expansion of the money supply, fuelling inflation. This was followed by periods of fiscal restraint, during which the Government has curtailed expenditures, substituted external for internal financing and repaid debts to the monetary system in order to restore macro-stability (World Bank, 1995a; Harringan, 2001).

This rollercoaster pattern of public spending has undermined attempts to impose a planned system of resource allocation within the public sector. Depreciation of the kwacha and periods of sustained inflation require unprogrammed increases in spending in order to maintain the real value of budget lines, such as those for drugs and teaching and learning materials. They also increase government's borrowing costs, by pushing up domestic interest rates – the Treasury Bill rate rose from 22.25% at the end of 1993 to 53% at the end of 1995, subsequently falling until inflation took off again in 1999, with the rate rising to 76.75% in December 2000. This has led to debt servicing crowding out other expenditures and setting off a vicious circle of increased spending, financed by borrowing, causing inflation and depreciation, and so requiring increased spending. When the government has sought to compress expenditures, much of the burden of cuts has fallen on developmental and service delivery functions. As a result, fiscal compression has tended to favour the administrative capture of scarce resources.

Implementation of structural adjustment during the closing years of the Banda regime brought the deficit before grants down to around 6% of GDP in 1991. However, controls on spending were relaxed during the transition to democracy, with expenditures increasing from 25% of GDP in 1991/92 to 42% of GDP in 1994/95, when the deficit before grants peaked at 26% of GDP (see, Figure 2 and Table 1). Although this period saw an increase in grants, primarily to finance the drought and electoral spending, net domestic borrowing also increased to nearly 9% of GDP. As a result, annualised inflation surged to 75% in 1995.

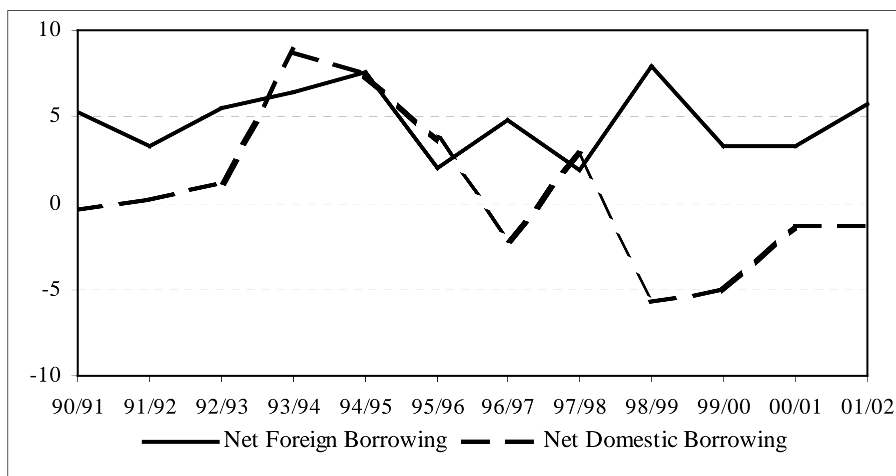
Expenditures were cut back sharply in 1995/96 and 1996/97, dropping to 24% of GDP, with the deficit before grants falling to 7.5% and average inflation to 9%. Stabilisation was achieved by introducing a rigorous cash budgeting system, supervised by an Expenditure Monitoring Unit in the Ministry of Finance and a Cabinet Committee. When expenditure controls were relaxed in mid-1997/98, expenditures started to increase again and the Government had further recourse to domestic borrowing. With expenditure and deficit targets off-track, the IMF imposed a six-month IMF staff-monitored-programme and the Government was forced to tighten cash-budgeting controls once again.

Figure 1: Expenditure as % of GDP
(Estimates and budget from 1999/00)



In the run-up to the June 1999 elections, the IMF reported unprogrammed increase in expenditures, provoked in part by the award of a 25% salary increase.[2] By the end of 1999 inflation had reached 44.8%, as compared with a target of 21%. Since then expenditures have continued to creep upwards, reaching 32% of GDP in 2000/01, with the deficit before grants rising to 14% of GDP. Substantial increases in grants, rising from 6% of GDP in 1998/99 to 12% in 2000/01, and external financing, enabled the government to finance increased spending without recourse to net domestic borrowing, though repayments to the banking system were curtailed.

Figure 2: Deficit financing as % GDP
(Estimates and budget from 1999/00)



The Government recognises that fiscal discipline is the key to macro-stability, growth and poverty-reduction. Recent policy statements stress the importance of closing the gap between spending and resources and set ambitious targets for the reduction in the deficit (MFEP, 2001: 21). In early 2000, the Ministry of Finance and Economic Planning announced a further round of belt-tightening with

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[2] Government and IMF public expenditure data differ throughout the time series, however, the divergence is particularly marked for fiscal year 1998/99. The IMF (2001) reports expenditures increasing to nearly 27% of GDP and the deficit rising to 11.5% of GDP in 1998/99 against a target of 7.1%. Government data (NEC, 2000) reports expenditures at 24% of GDP and the deficit at 8.2% of GDP, both only slightly higher than the year before.

its 'Ten-Point Plan', followed by additional expenditure controls in the 2001 Budget speech (see Sections 5.1 and 5.2). This offers part of the solution. However, if deficit reduction targets are to be met and public spending stabilised, the government must also address structural weaknesses in public finances and financial management systems.

Key policy and institutional problems to be addressed include:

- **Weak administrative controls.** Much of the increase in public expenditures in 1992/93 to 1994/95 was unplanned, arising instead from the weakening of effective controls on agency spending rather than government policy (see Section 5.2). Unauthorised expenditures rose to 1.75% of GDP in 1994/95 (IMF, 1997). Cash budgeting provides the means for MoF to reassert control of agency spending, though it has proved difficult to maintain these controls over an extended period. When controls have been relaxed, unprogrammed expenditures have increased quickly, as in 1997/98 and 1999/00. This, together with the persistence of substantial extra-budgetary expenditures, approved at Cabinet level, often against MFEP's better judgement, reveals the relative weakness of the MoF. MoF is able to assert its authority when the deficit reaches unsustainable levels and international financial institutions have intervened. Its influence seems to decline once the economy has been stabilised, when the demands of spending agencies tend to take the upper hand. Administrative measures to curtail agency spending are unlikely to be effective in the absence of high level political commitment and the empowerment of the MFEP to control agency expenditure.
- **Electoral cycle spending.** Periods of weak fiscal control coincide with the electoral cycle. Significant increases in public spending are recorded in the lead-up to the 1995 and, to a lesser extent, 1999 elections, followed by sharp cuts in spending shortly thereafter. While it is not possible to demonstrate that specific expenditures were motivated purely by electoral considerations, it is noteworthy that capital spending on rural water supplies – an area of spending susceptible to short-term manipulation and pork-barrelling – increased markedly in both election years. Furthermore, the timing of major policy decisions, such as the introduction of UPE and the scaling-up of the Starter Pack Programme, have tended to precede elections, establishing long-term commitments which are more difficult to adjust downwards once the immediate political benefits have been reaped. Again, high-level political commitment to macro-stability, taking a long-term view on economic policy, is the only effective solution to this problem.
- **Wage bill pressures.** Following the first civil service strike, the Banda government announced across-the-board increases in public sector pay, leading to a jump in salary expenditures from 4.5% of GDP 1991/92 to 6.2% of GDP in 1992/93. Further increases in public sector pay followed in 1994/95, together with a massive increase in civil service numbers with the appointment of 22,000 teachers to meet UPE targets and increases in the number of extension workers. After peaking at 7.3% of GDP in 1994/95, the wage bill subsequently declined as a share of public spending. This was achieved by laying off 14,000 temporary staff in 1995/96 and imposing wage increases lower than inflation. However, pressures on the wage bill persist, with total spending on wages and salaries increasing by around 30% in 2000/01. Ultimately, wage bill pressures can only be alleviated by reducing the payroll burden, through retrenchment and salary reform, and by the reduction of inflationary pressures through macro-stabilisation.
- **Poor revenue performance.** Revenue yield as a share of GDP fell from 21% in 1990/91 to just 15% in 1997/98, with reductions across all major components of revenue (see Table 5). In an effort to reverse this decline, an autonomous Malawi Revenue Authority, financed from a share of revenue retentions, began operations in 2000. Preliminary data suggest that this has improved collections performance, particularly in the corporate sector, with programmed yields rising to 17.4% of GDP in 2000/01. At the same time, the Government

is committed to the reduction of tax rates in order to widen the tax base and improve compliance. Both the IMF and opposition parties have criticised this policy, the former on the grounds that the incentive effect is unlikely to offset the immediate reduction in revenues, the latter on the grounds that the tax burden will be shifted to smaller, Malawian enterprises. After extensive consultation, the National Assembly finally approved extention of the surtax to the retail sector and its eventual transformation into a value-added tax.

- **Loss-making parastatals and agencies.** Parastatals have tended to perform badly, incurring substantial losses, which have to be met by the State, usually during downturns when Government finances are already tight. The IMF has voiced particular concern regarding Agricultural Development and Marketing Corporation, which supports prices during droughts, and the National Food Reserve Authority, which stockpiles grain, and the Petroleum Control Commission, which imports petroleum products. Progress in privatising and restructuring enetreprises has been slow. However, the Government recently established a Public Enterprise Reform and Monitoring Unit, and has restricted interventions in the maize market and privatised the import of oil products. Nevertheless, concerns remain that the public enterprises do not have effective expenditure controls in place and may require periodic bailouts, particularly where they lack sufficient funds to service debt to commerical banks (IMF, 2001b). Clearly these risks can only be removed by privatisation, though this requires a political commitment that has so far been lacking.
- **Unpredictable external financing.** Given the Government's dependence on external financing, which covers an estimated 40% of recurrent and 80% of development spending, predictable and timely disbursements of development assistance are crucial to effective budgetary management. In recent years, MFEP has argued that lower than programmed and delayed disbursement of assistance has forced the government to revise expenditure outturns – in 1999/00, for instance, the development budget was cut back by nearly 30% in-year owing to shortfalls on aid disbursements – and resort to short-term domestic borrowing in order to make up short-falls. The latter claim is difficult to justify where a substantial volume of assistance is channelled through projects, and so expenditures are automatically adjusted for falls in disbursement. However, it is clear that the growing proportion of aid delivered as budget support will increase the Government's susceptibility to these risks (see Section 5.4).

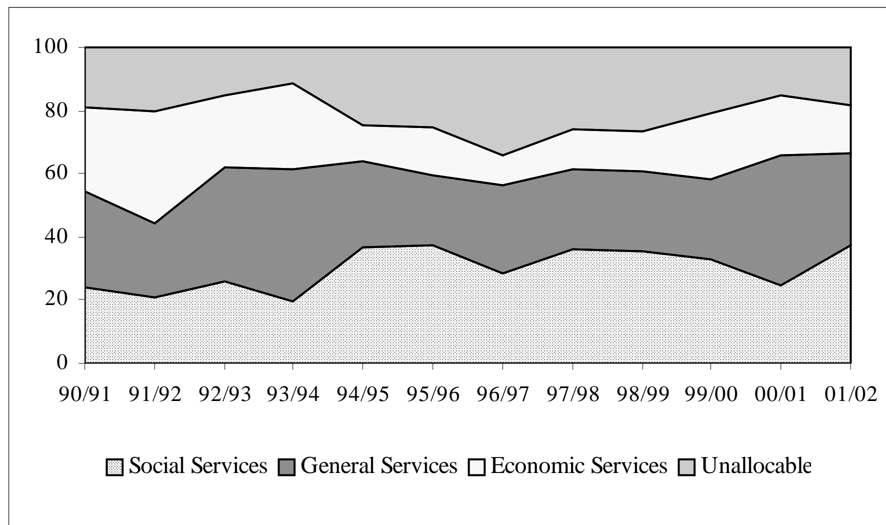
4.2 Resource allocations

Under Banda, resource allocations favoured investments in economic infrastructure, which were seen as providing the basis for economic development in the formal sector. Economic services accounted for 35% of total spending in 1991/92 and nearly two-thirds of investment (see Figure 3 and Table 7). Social spending, in contrast, accounted for just 20% of total spending.

The democratically elected UDF government imposed very different priorities. From the very start, the Government increased allocations for social services, which rose from 21% of total spending in 1991/92 to 41% in 1995/96 and averaged 37% of total spending from 1994/95 to 2001/02. Much of this increase was accounted for by increases in spending on education, with education's share of total spending rising from 10% in 1993/94 to 19% in 1997/98. During this period, when Government had to build primary schools to accommodate increased demand following the introduction of Universal Primary Education, education absorbed nearly one quarter of all public investment. Education's share of total spending subsequently fell to 13% in the 2001/02 budget and has averaged 14% over the 1994/95 to 2001/02 period. Health's share of spending has also increased, rising from 7% in 1991/92 to 11% in 1995/96, then falling in the late 90s to recover at nearly 12% in the 2001/02 budget (with an average of 9% from 1994/95 to 2001/02). Spending on welfare (excluding pensions) and community development had followed a similar trend, with

average shares of 3% and 5% of total spending from 1994/95 to 2001/02. Within the latter category, rural water supply has been the most important area of expenditure, accounting for 18% of total development expenditure from 1994/95 to 2001/02. Substantial increases in spending on rural water have occurred in pre-election periods, rising to 22% of development spending in 1994/95 and 24% in 1998/99.

Figure 3: Structure of Total Expenditure by Function, %



In contrast, spending on the economic sectors has fallen under the UDF Government, from 35% of total spending in 1991/92 to an average of 16% over the 1994/95 to 2001/02 period. There have been significant cuts in support to the industrial sector, transport and communications and agriculture, with the latter's share falling from 15% in 1991/92 to 7% over the 1994/95 to 2001/02 period. Although agriculture is central to the Government's poverty reduction strategy, spending has been curtailed owing to the lack of a coherent sectoral strategy.

While the overall trend points to a increase in social spending under the UDF government, the time-series reveals that social spending has periodically been severely compressed, most notably in 1996/97 and 2000/01 when spending and budgeted allocations fell to 33% and 28% respectively. This compression has been caused by two factors: firstly, unprogrammed increases in spending on general services, mostly administration; and secondly, increases in spending on domestic debt service.

The closing years of the Banda regime and democratisation period saw rapid increases in spending on administrative services, with its share of total expenditure rising from 20% in 1990/91 to a 35% in 1993/94. This was partly a consequence of the pay rises awarded in 1993, but was also due the collapse of budgetary discipline, which allowed uncontrolled spending on investment and goods and services that benefited the bureaucracy rather than service delivery. Under the UDF Government, administrative expenditures were contained at 16% of total spending in 1995/96 and remained slightly under 20% until 2000/01, when the share rose again to 35% of total spending. This increase appears to be have been caused by a relaxation of expenditure controls, with a substantial part of the expenditures related to a clearance of agency arrears.

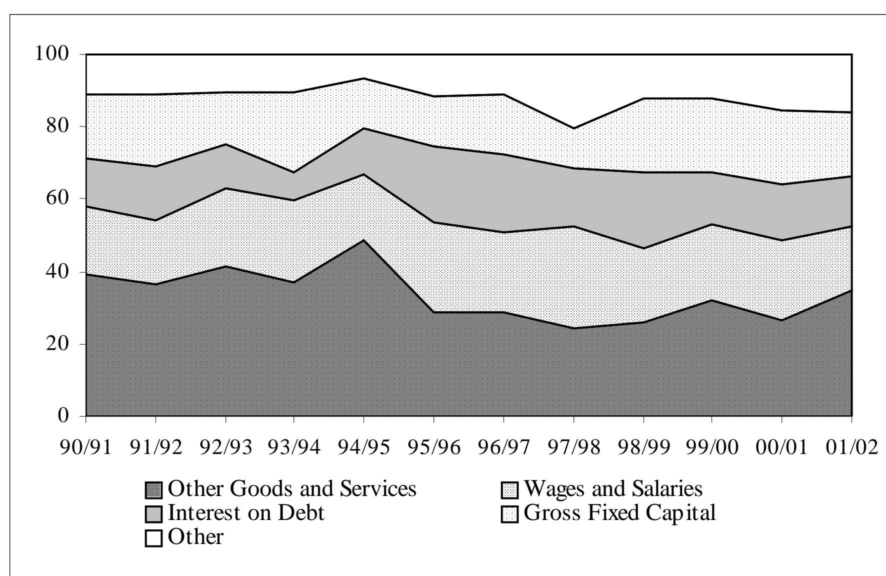
Debt servicing expenditures[3] increased significantly in the first years of UDF Government, rising from 15% of total spending in 1991/92 to a peak of 22% in 1996/97, with a second peak in 1998/99,

[3] In the Functional Classification used in Malawi, debt servicing is included in the category "unallocable expenditures", which aslso includes spending on pensions and gratuities.

though these expenditures have subsequently tailed off, averaging 17% of the spending for 1994/95 to 2001/02 (see Table 6). This pattern is largely explained by increasing costs of debt servicing owing to increases in domestic interest rates during periods of high inflation and external borrowing costs following the depreciation of the kwacha (see Section 4.1). When debt servicing costs have increased, the Government has had to cut discretionary spending, with part of this burden falling on the social sectors and spending on goods and services throughout the public sector.

Data on the economic classification of expenditures reveals a significant decline in the share of resources allocated to goods and services (see Figure 4 and Table 6). In 1991/92, goods and services accounted for 36% of total spending. This share increased to 49% in 1994/95, largely due to unprogrammed increases in spending by the administration rather than expansion of services. Thereafter, goods and services spending declined to just 24% of total spending in 1997/98, taking the brunt of the expenditure controls imposed under the cash-budgeting system. Spending on goods and services subsequently increased, but still remains below the levels of the early 1990s. However, the ratio of spending on goods and services in relation to salaries increased from 0.49 1991/92 to 0.69 over the 1994/95 to 2001/02 period. Despite increases in payroll, largely owing to the recruitment of over 22,000 teachers to support the expansion of primary education, the proportion of spending on salaries has not increased significantly during the late 1990s – though short-term increases have occurred in years in which the government has made significant pay awards – averaging 21% from 1994/95 to 2001/02 as compared with 18% in 1991/92.

Figure 4: Structure of Total Expenditure by Economic Category, %



At the sectoral level, the evidence a reallocation of expenditures towards poverty reduction goals is strongest in the education sector (see Table 8). Under Banda a disportionate share of recurrent spending was allocated to secondary education, which accounted for 16% of sector spending in 1991/92, but only 2% of school students, while primary education's share was only 64%. Over the 1994/95 to 2001/02 period, primary education's share increased to 73%, peaking at 77% in 1997/98. Much of this increase has been generated by reducing the share of spending on administration, rather than cutting allocations to secondary education, though these have fallen slightly. However, following the Government's decision to expand and upgrade secondary education and teacher training, these components of sector spending have increased significantly. Teacher training was identified as a priority poverty expenditure by the PRSP Technical Committee. The efficiency and effectiveness of education spending have been undermined by the

limited resources available for goods and services, leading to shortages of teaching and learning materials. Recent budgets have sought to increase this allocation, which has risen from 7.9% of budgeted sector recurrent spending in 1999/00 to 9.1% in 2000/01. Again, teaching materials are identified as a priority poverty expenditure.

Measures aimed at improving the performance and coverage of the education system remain severely constrained by shortages of funds. Fiscal projections prepared by the World Bank demonstrate that there is little prospect of the government having the necessary levels of finance in the near future since even a moderate expansion of primary and secondary education would consume 33% of recurrent budget by 2005 (World Bank, 1998a). In this context, the Ministry of Education has sought to increase cost-recovery. Government spending per pupil at secondary boarding schools is estimated at K7,838, though fees amount to only K6,000, as compared with average charges of K25,000 at private schools. In 2000, the Government announced that secondary school cost-sharing would be phased in over a three-year period, with part of the proceeds fed into a bursary scheme to facilitate access for the poor. Boarding subsidies for secondary schools are gradually being phased out, with their share of secondary education spending falling from 16.1% in 1999/00 to 8.7% in 2000/01.

Unfortunately, the classification of health expenditures used in State Accounts up to 1999/00 does not support detailed analysis of expenditure, though sectoral studies report that more than two-thirds of sector spending was directed at secondary and tertiary level curative care (MoHP, 1999). Data from 1999/00 and subsequent budgets points to a significant increase in recurrent spending at primary level, in line with the Ministry of Health's policy to prioritise front-line services (MoHP, 1999). The Government also reports increases in spending on pharmaceuticals and medical supplies through the Central Medical Stores, rising from \$0.60 per in 1994/95 to \$1.17 per capita 2000/01 budget (MFEP, 2001). However, it is unclear what proportion of these funds actually reach intended beneficiaries. The Pharmacy and Medical Board estimates that up to 60% of all drugs are diverted from the public health system.

The Ministry of Agriculture's performance is much weaker. Data on recurrent expenditures reveals that the bulk of sector recurrent expenditures are spent on administration at the Ministerial and Divisional level, with administrative expenditures increasing from 59% in 1991/92 to an average of 66% from 1994/95 to 1999/00. Although budgeted share of administration costs is programmed to decrease in 2000/01 and 2001/02, releasing funds for service delivery, the Ministry of Agriculture has consistently diverted resources from service to administration during budget execution, and so budgeted allocations are unlikely to be a fair indicator of outturns.

Expenditure outturn data reveals that the Government has succeeded in reallocating resources to the social sectors in line with poverty reduction policies. These allocations have declined during years of weak budgetary controls, when the share of administrative services has tended to increase, and during periods when increased debt servicing obligations have led to the compression of discretionary expenditures. However, the underlying trend demonstrates a strong commitment to social development. At the sectoral level too, expenditure data points to a reallocation of resources in line with policy priorities in the education and health sectors. Both of these sectors have clearly formulated policies and development strategies. In the agricultural sector, in contrast, where policies and development strategies have yet to be defined, the bulk of resources are captured by administrative services.

4.3 HIPC and the PRSP

In 1999, Malawi's external debt stock amounted to $2,608 million, with a net present value of $1,482 million, equivalent to 82% of GDP, 269% of exports of goods and services, and 516% of Government revenues. About three-quarters of this debt was owed to multilateral finance institutions and one-fifth to Japan, with only 2% owed to Paris Club bilaterals. Pre-HIPC debt servicing was forecasted at $104 million a year from 1999-2009, with an average debt service to revenue ratio of 16%.

Optimistic assumptions have been used in determining the level of sustainable debt service and debt relief under HIPC. 3% GDP growth is assumed for 2001, rising to 4.5% in 2003 and 6% thereafter, supported by rising levels of domestic savings, foreign direct investment and steady export growth. Revenues are expected to increase to around 20% of GDP by 2004, with a gradual reduction in grants to around 6% of GDP. On this basis, HIPC relief was set at $643 million, with an average reduction in debt servicing of $50 million year over the 2001-2019 period and the ratio of debt service to revenues falling from 17 to 8%. Total assistance for 2000/01 to 2002/03 is programmed at $91.4 million (IMF and World Bank, 2000).

Donors and civil society organisations have sought assurances that the Government will apply resources released by HIPC initiative on poverty reduction programmes. The mechanism proposed in the PRSP Technical Committee's 'Findings to Date', issued shortly before the presentation of the 2001/02 budget, and subsequently endorsed by NGOs and donors, was to designate priority poverty expenditures (PRSP-TC, 2001). Imitating Uganda's Poverty Action Fund, these would constitute a virtual fund, separately identified in the budget documents and tracked during execution. However, budget documentation failed to identify the priority poverty expenditures and the Minister of Finance and Economic Planning gave only assurances that 'debt relief funds will be spent on poverty reducing programmes and will be monitored separately' in his budget speech (MEFP, 2001).

The National Assembly's Budget and Finance Committee noted that the Government had not provided a complete breakdown of the application of HIPC funds in 200/01 and in the intended application in 2001/02. It also commented that 'given the exigencies of the cash budgeting system and continuing difficulty in controlling uses of funds within Ministries, this general assurance [regarding the application and monitoring of funds] provides little comfort' (BFC, 2001). In response, the Minister's wind-up speech gave further details of the application of HIPC funds, admitting that not all of the available funds had been committed, though it was intended to present a supplementary budget – the first for more than a decade – indicating the proposed allocation of the balance. However, the Government still made no commitment to introduce a virtual fund, other than to reiterate the assurance that 'there are elaborate funding procedures for the activities which are separate from the normal funding of government operations' (MFEP, 2001a). It is difficult to imagine how these procedures can effectively track and ring-fence priority expenditures without previously specifying the programmes and activities to be financed.

So far, it has not been possible to link the PRSP and budget processes. This is partly because of delays in start-up which meant that the 'Findings to Date', intended as a guide for budget preparation, were issued too late for use by spending agencies (see Section 2.3). Furthermore, PRSP working groups were not directly involved in budget preparation. However, the principal constraint has been the lack of a resource framework for the preparation of sectoral and cross-cutting strategies, which meant that guidelines, when issued, gave no indication of the appropriate resource allocations. A resource framework was finally disseminated in June 2001. This was not based on the MTEF, but rather on the macro-framework agreed with the IMF for the 2000/01 to 2004/05 period, with sectoral resource allocations based on the approved shares of the 2000/01. Minor

adjustments were made to increase the shares of some of the thematic groups (such as science and technology and nutrition) but otherwise the allocations were simply incremental. Moreover, the thematic groups were advised that the ceilings were merely 'ballpark' figures to assist in prioritisation and costing of the strategies, which would subsequently be refined through an 'iterative process'. Consequently, their usefulness as a basis for resource programming and planning was limited. Closer linkages between poverty planning and budgeting ultimately depend on the development of appropriate resource planning tools. This is one of the goals of the Government's public expenditure management reforms.

5 Public Expenditure Management

5.1 Reform strategies

In 1994 the World Bank undertook a Public Expenditure Management Review in order to determine what had provoked massive expenditure overruns in execution of the 1993/94 budget, identify the extent of administrative capture of scarce resources and underfunding of front-line services, and pinpointing the cause of implementation delays for development programmes. The review proposed reforms in three broad areas of public expenditure management:

- resource planning and budgeting, aimed at stabilising the budget deficit and improving strategic prioritisation in resource allocation;
- controls on public spending, in order to ensure adequate oversight and compliance; and
- aid and debt management.

Although the proposed reform programme covered the whole budgetary cycle, considerable emphasis was placed on budget preparation, since, it was argued, many of the problems in resource management stemmed from the system's 'failure to reconcile needs with available resources' (World Bank, 1995: ii). For the World Bank, 'the single most important institutional reform needed is to implement a system of forward budgeting' (1994: 11), in order to provide a realistic basis for budgeting estimates. Consequently, the reform programme implemented from 1995 to 1999, was built around the introduction of a Medium Term Expenditure Framework and Integrated Sector Programmes.

Subsequent experience suggests that this emphasis was misplaced. While forward resource planning is crucial, improved budgeting is unlikely to generate the desired results where there is weak budgetary compliance and oversight. As this chapter will demonstrate, attempts to introduce improved planning and budgeting instruments failed, partly because of design weaknesses in the instruments themselves, but more fundamentally because the budget execution system was unable to control agency spending.

During the late 1990s, the underlying weaknesses of the expenditure control systems became increasingly apparent, leading to the suspension of the ESAF in 1998 and the temporary imposition of a staff-managed programme. Furthermore, reliance on cash-budgeting – rationing of cash releases to spending agencies in line with revenue yields – as the principal tool for budgetary stabilisation, while effective, undermined service delivery and led to the administrative capture of scarce resources. Consequently, attention gradually turned to the development of the backroom functions – accounting, treasury management and auditing – that provide routine expenditure controls. Implementation of a computerised Integrated Financial Management Information System is central to the Government's strategy in this area. Enforcement of expenditure controls has also been given higher profile. In early 2000, following the appointment of a new Minister of Finance, the MFEP announced a 'Ten-Point Plan' that included changes to procedures aimed at strengthening MFEP's control of agency spending (MFEP, 2000).

The shift in focus from resource planning to expenditure control has left the public expenditure reform programme without a clear sense of direction. Although the 'Ten Point Plan' and subsequent budget documents reaffirm MFEP's commitment to the MTEF and on-going expenditure planning reforms, including a number of measures that are intended to carry these reforms forward – such as the introduction of public pre-budget consultations – the MFEP has failed to take the measures needed to properly institutionalise the new budgeting and planning instruments. Indeed, the August 2000 MTEF 'action plan' prepared by an inter-ministerial team, led by MFEP personnel, has yet to

be approved. Consequently, the MTEF, once the focal point of the reform programme, is now marginalised in the Ministry's day-today work. Aside from the immediate measures identified in the 'Ten Point Plan' and the short-to-medium term reform measures identified in the Policy Framework Papers, there is no comprehensive public expenditure management reform paper setting out a vision of the reformed system and implementation strategy. The impression given is one of a series of disjointed reforms, often implemented in isolation by MFEP departments, without a sense of strategic orientation.

Successful public expenditure management reforms require strong political commitment to overcome the vested interests benefiting from dysfunctional systems, particularly where these reforms have to be rolled-out beyond the Ministry of Finance to the line Ministries. In Malawi, most commentators agree that political commitment has been weak and that reforms have been imposed by international partners. The Functional Review of MFEP, for instance, refers to the 'unwarranted pressure from outside the ministry to implement budget reforms before proper assessment' (OPC, 1999: 50). An independent evaluation of the ESAF recognises as much: referring to the government-wide reforms introduced from 1995 it suggests that 'a feeling of imposition quickly took hold', 'the base of political commitment in government was, from the very beginning, very narrow', and that 'the bureaucracy. remained half-hearted at best and cynical about the reforms and the role of the rising numbers of well-paid external technical advisors' (Botchwey et al, 1998: 80-81). International partners have tended to rely on the MoF's ability to push through reforms, overriding vested interests in other Ministries. This was probably unrealistic; Malawi's MFEP is not a superministry, but more one among equals. Its authority over line ministries tends to be strong during periods of fiscal stabilisation, but weakens once the deficit and other macro-economic variable have stabilised. This may reflect the coalition nature of UDF governments, which makes it difficult to discipline cabinet's spending decisions. Furthermore, resistance to reforms in the civil service – from vested interests, but also from reform fatigue – was probably underestimated.

Institutional and legislative measures did not figure prominently in the 1995 reform programme, though these have subsequently emerged as important constraints on the functioning of the public expenditure management system. In 1998, the investment planning functions were transferred from the National Economic Council to the new Ministry of Finance and Economic Planning. The 1999 Functional Review suggests that the merger of these functions did not proceed smoothly, with staff being assigned to posts haphazardly, and little was made attempt to integrate NEC planning activities into MFEP routines (OPC, 1999). Furthermore, information flows between MFEP departments are poor and senior managers rarely meet, departments tending to operate independently with little knowledge of reform initiatives elsewhere in the Ministry (MFEP, 2000a; interviews, July 2001).

Significantly, most line Ministries have maintained separate planning and financial management departments, so that benefits of consolidating these functions have been difficult to extend beyond MFEP. Reforms have, moreover, been built onto an outdated legislative framework for public expenditure management, which does not properly accommodate current practices. The Finance and Audit Act dating from 1962 and last revised in 1967, for instance, does not reflect the decentralisation of the payments system in 1988, let alone recent developments in planning and budgeting. In these circumstances, the reform programme has been a largely technical exercise, lacking the force of law. Legislative reforms are now under debate. Hopefully, this will provide a renewed impetus for the reform programme.

Implementation of expenditure management reforms has encountered problems at various levels: the prioritisation of resource planning instruments in an environment where expenditure controls are weak failed to bring about the desired improvements in expenditure management practice; the

absence of a comprehensive expenditure management reform programme has led to reforms stalling and a lack of strategic direction; the reliance on the MFEP as the driver of reform, overestimated the Ministry's authority over line agencies; and lastly, reforms have been handicapped by the lack of an appropriate, government-wide institutional and legislative framework. The implications of these problems for the public expenditure management reforms are discussed below.

5.2 Improving budgetary compliance

Malawi's record in the area of budgetary compliance is poor: there are substantial deviations between planned and actual outturns at the aggregate level and at the level of the individual vote. Table 2 demonstrates the extent of budgetary variance against various revenue and expenditure indicators (positive variance indicates that outturns were higher than planned and negative variance indicates that outturns were lower than planned).

Table 2: In-Year Budgetary Variance

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
% Variance on Revenue and Grants		-4.7	15.5	4.4	3.5	1.4	1.5	11.4
% Variance on Revenue		-19.9	22.1	5.6	0.1	20.2	9.6	8.4
% Variance on Grants		32.5	3.0	0.4	19.9	-28.7	-12.1	16.4
%Variance on Expediture	-18.2	44.8	15.2	17.0	1.6	18.8	34.8	-16.4
% Variance on Statutory Expenditures	46.9	-66.2	151.2	54.2	-6.2	61.1	124.4	-28.1
% Variance on Votes	-30.4	73.8	-19.3	-1.9	5.5	-1.9	9.0	-9.5
Sum of Vote Execess as % Original Budget	18.4	80.5	11.2	10.6	10.1	6.9	12.9	16.7
Sum of Vote Cuts as % Original Budget	-48.9	-6.7	-30.6	-12.5	-4.6	-8.8	-4.0	-26.2
% Votes less than 90% of budget	7.7	12.2	50.0	44.2	36.0	22.9	4.4	13.3
% Votes greater than 110% of budget	56.4	70.7	22.0	30.8	20.0	35.4	53.3	51.1

Source : MFEP, Budget Estimates and Approved Accounts (Interim Accounts for 2000/01).

Variance on revenue forecasts has tended to be positive, other in 1994/95 when revenue yields were reduced by drought and weakened tax collection effort in the run-up to elections. Greater difficulties have been encountered in accurately predicting the level of grant financing, which was significantly lower than originally predicted in 1998/99 and 1999/00. Variance on aggregate expenditure is not closely related to variance on revenue, with significant increases in expenditure during periods of reduced revenue yield, as in 1994/95, and in-year increases in spending exceeding the growth in revenues and grants in 1996/97, 1998/99 and 1999/00, leading to higher than programmed deficits. Expenditure outturns have been lower than planned in only two years since the transition to democracy, in 1993/94 and 2000/01.

In-year increases in expenditure have sometimes been driven by unprogrammed increases in statutory expenditures, largely debt, usually as a result of exchange and interest rate fluctuations. However, there is also evidence of considerable in-year variance against voted recurrent expenditures (expenditure by agencies). The sum of excess votes amounted to a staggering 80% of the original budget in 1994/95. Since then, the volume of excess expenditures has reduced, but has generally remained above 10%. In periods of fiscal austerity, when vote expenditures have been cut by rigorous cash budgeting, as in 1995/96 and 2000/01, cuts have exceeded excess votes. However, in any one year more than half of public institutions receive either 10% less or 10% more than originally programmed, and it is by no means uncommon for institutions to receive allocations that are 30% higher or lower than originally anticipated. Even extra-budgetary expenditures, approved during the budget year, may not be executed owing to the MFEP's refusal to release funds; in

2000/01 only one quarter of the 1.6 billion Kwacha of extra-budgetary funds was actually disbursed. Inevitably wide variance on voted expenditures renders the budget irrelevant as a guide to resource availability during budget execution, thereby weakening the rationale for detailed budgeting, undermining operational planning and subverting parliamentary oversight.

During the 1997/98 to 2000/01 period, the three key poverty reduction sectors – education, health and agriculture – have been net beneficiaries of budgetary variance, with recurrent expenditures 11% higher than budgeted, while overall voted expenditures have been only 4% higher. Nevertheless, these sectors have not always been protected from in-year cuts: health, in particular, received substantial in-year cuts in expenditure in 1995/96, 1996/97 and 1998/99. Furthermore, it is by no means clear that in-year increases in expenditure have always been applied in poverty reduction activities. Analysis of budgetary variance by economic classification of recurrent expenditures, available only for 1999/00 and 2000/01, suggests that the bulk of the in-year increase in recurrent expenditures has been allocated to administrative overheads (travel, utilities and office supplies), which were 40% over budget for the two years combined, whereas in-year increases for medical supplies amounted to 32% (all in 2000/01), and allocations for educational supplies (-28%), agricultural inputs (-58%) and maintenance (-15%) have all been lower than planned. This suggests that in-year changes in budget allocations have tended to favour administrative capture, to the detriment of services delivered to the public.

Clearly, improvements in the poverty reduction impact of public spending, as well as longer-term macro stability, depend on improvements in budget execution, so as to minimise variance between planned and actual outturns. The principal causes of poor compliance and proposed solutions in the Government's reform programme are identified below, together with an analysis of the likely success of the reforms and additional measures that may be needed if compliance is to be achieved.

Controlling extra-budgetary expenditures

One of the principal causes of budgetary variance in Malawi is the practice of administrative approval of extra-budgetary (additional) expenditures during budget execution. Extra-budgetary expenditures are commonly used as a means of meeting unforeseen expenditures, such as those arising from natural calamities or economic shocks, and occasionally, to meet core government expenditures that were anticipated during budget formulation but could not be accurately costed, such as elections and pay awards. In many countries, provision for such contingencies is usually made through a budgetary reserve, held by the Ministry of Finance. Since extra-budgetary expenditures alter the appropriations approved by Parliament, parliamentary oversight is ensured by the requirement for the Government to present a Supplementary Budget for parliamentary approval before executing excess expenditures.

In Malawi, the 1962 Finance Act makes provision for both of these instruments. However, the MFEP has, in recent years, preferred to programme available resources at the start of the budget process, leaving little or no slack for contingencies. Consequently, extra-budgetary expenditures have to be accommodated by increases in aggregate spending or by reallocating resources between institutions. Government does not present a Supplementary Budget discriminating these extra-budgetary expenditures for formal parliamentary approval. Instead, a revised budget is presented in the following years' Budget Estimates, for information purposes only, in order formalise extra-budgetary expenditures and other alterations retrospectively.

As a result, the approval of extra-budgetary expenditures has become an administrative exercise. This has made it easier for the Government to change budget allocations in-year and so increased pressure on the MFEP to accommodate requests for extra-budgetary expenditures by agencies –

regardless of their implications for the deficit or compliance with approved allocations – either through Ministerial interventions, appeal to Cabinet or to the Presidency. Extra-budgetary expenditures are not only used to meet emergencies, but also to meet administrative costs that should have programmed in the original budget and were omitted either by mistake or as a way of getting round notional budget ceilings. Since extra-budgetary requests are submitted and approved throughout the year, it is impossible to assess the trade-offs between requests for extra-budgetary expenditures from different Ministries. Besides, political intervention to ensure the approval of extra-budgetary expenditures means that resources tend to be diverted to those Ministries with the greatest influence, rather through a rational planning process.

MFEP's 'ten-point plan' recognised that extra-budgetary expenditures have undermined aggregate expenditure discipline and the planning process. The solution proposed was to restrict extra-budgetary expenditures to legitimate emergencies. In the face of political pressures, this policy has proved difficult to implement, not least because agencies and their political heads see extra-budgetary expenditures as a legitimate and established budgeting practice. Indeed, in 2000/01 half of all votes benefited from extra-budgetary expenditures and in July 2001, only days after the 2001/02 budget was approved by Parliament, MFEP had already received two requests for extra-budgetary expenditures.

Cabinet-level commitment to hard budgetary constraints is essential if budgetary discipline is to be restored. Once there is political commitment, the introduction of quarterly or bi-annual budget revisions, in which all extra-budgetary requests would be reviewed simultaneously, to assess their impact on the expenditure aggregates and the trade-offs between alternative applications of additional resources or between increases and cuts in allocations, would provide an opportunity for more rational decision-making regarding in-year alterations. Enforcement of the requirement for the Government to seek Parliamentary approval for increases in appropriations, through a formal Supplementary Budget, would be the ideal. This would improve transparency and act as a break on agency requests, since requests for additional resources would have to be justified publicly and the Government would be unlikely to present more than two supplementary budgets in each year. The MoPF's announcement of a Supplementary Budget for 2001/02 – for the first time this decade – to allocate resource released by HIPC, offers some encouragement in this respect. Hopefully, this will become a routine.

Controlling agency expenditures

In 1986, the Government dismantled its centralised payments and accounting system, which allowed for pre-payment audit of agencies' transactions, and established decentralised Treasury Payment Accounts at the Reserve Bank for most Ministries, so that transactions could be processed by agencies themselves. Until recently, these accounts were replenished monthly, against the submission of agency accounts. In principle, agencies' internal controls, coupled with monthly reporting and the treasury funds release, should have guaranteed that agency expenditures complied with cash limits, thereby preventing budgetary overruns.

These controls proved inadequate when agencies ceased to enforce commitment and expenditure procedures during the transition to democratic rule and subsequent attempts to contain expenditures. Not only did agencies overspend, processing payments without coverage, but they also resorted to promissory notes and suppliers' credits, leading to a build up of arrears. In December 1998, the Auditor General reported that arrears accumulated between end-March 98 and October 1999 had risen to 1.2% of GDP (IMF and World Bank, 2000: 9; AG, 1999: i). This reflected a generalised breakdown of budgetary discipline, in a situation where 'senior managers in ministries and departments believe that overspending is justified because the votes they are given

are no longer realistic in relation to the services they are mandated to provide' (World Bank, 1995: 44), irrespective of the consequences for macro-economic management.

At the same time, external controls, which should have identified and prevented agency mismanagement, were hampered by: the multiplication of agency bank accounts, which made it difficult to monitor agencies spending; the routine clearance of agency transactions by the Reserve Bank, even where these transactions had no coverage; delays and inconsistencies in agencies accounts; and the Government's unwillingness to punish or surcharge accounting officers for overspending. Agency accounts were transferred to commercial banks in 1995, with strict instructions for banks not to provide overdraft facilities. However, agencies continued to over-commit, usually by taking delivery of supplies before payment, against standing instructions, and the banks continued to honour cheques without coverage, since overdrafts were routinely cleared by the Reserve Bank. This subverted MoF's attempts to impose cash budgeting and created additional costs, since commercial banks held substantial balances of public funds, which were often used for the purchase of treasury instruments, so that the government was, effectively, borrowing its own money (IMF, 1996).

Measures intended to strengthen controls on agency expenditure are a key component of the MFEP's expenditure management reforms introduced in 2000 (MFEP, 2000; MFEP, 2001). Over the short-term, these include:

- Consolidation of agency bank accounts, reducing the number of accounts to around 800 from above 3,000, and replacement of advances with credit ceilings. These measures have eliminated balances in non-interest bearing accounts and, in principle, should ensure that commercial banks only process transactions which have coverage within agreed ceilings.
- Implementation of a commitment control system, whereby agencies register commitments as they are made, as well as when payments are liquidated with quarterly reconciliations and clearance of outstanding balances by the Accountant General. Again in principle, this should enable agency accounting officers to track expenditures more effectively, avoiding the build-up of uncovered arrears.
- Rigorous enforcement of monthly financial reporting by agencies, including regular bank reconciliation, and consolidation of government-wide expenditure reports on the same basis, with quarterly publication of government-wide reports through the MFEP's website. The MFEP has indicated its intention to freeze agency accounts if expenditure returns are not submitted on time.
- Additional controls on specific items of expenditure, including reductions in foreign travel allowances and restricted entitlement to business class travel, limits on the number of pool vehicles and fuel allowances, and the monetisation of rental allowances, with plans for the rationalisation of office space – reducing the amount of expensive, rented accommodation – and vehicle fleets.

Ultimately, however, these measures can only be effective where agencies' financial management systems are able to generate timely and accurate information on expenditures. At present, the largely manual accounting systems are unable to fulfil these requirements. The Accountant General's Department estimates that agency expenditure returns are only 60% accurate (interview, July 2001). This is partly because of registration and compilation errors, a problem compounded by the introduction of new classifiers in 1999/00, failure to undertake basic procedures, such as regular bank reconciliations, and delays in the presentation of accounts by district cost-centres. It also reflects more fundamental capacity constraints.

The Accountant General's Department planned to introduce an Integrated Financial Management System (IFMIS) at agency level – first in education, health, finance and agriculture, in August

2001, then rolling out to the rest of Government in November 2001 – which should improve accuracy. However, IFMIS is only to be applied at central level; district cost-centres will, in the first phase at least, continue to use manual accounts, which will be entered by the agencies' central account department on a batch basis. Consequently, problems of timeliness are likely to persist, with the system operating at the speed of its slowest link. The decentralisation programme, providing for the transfer of key service delivery functions to local government, may resolve this problem in the longer-term. However, decentralisation will also pass the burden for financial management down to the district level, and so must be accompanied by the strengthening of systems at these levels, including the design of an appropriate local government IFMIS. Work on this task has only recently got under way.

Improvements in financial information must also be accompanied by systems reforms aimed at strengthening procedures and ensuring compliance. As of July 2001, the MFEP had still to finalise its Financial Information Systems Strategy, which should address these concerns by identifying the requirements for systems re-engineering at agency level. Internal audit functions, which support agency accounting officers in systems design and procedural enforcement, will also have to be strengthened. Not all Ministries have internal auditors and concerns have been raised regarding the competence of the staff assigned to these units. In the wake of a procurement scandal in the education sector – where contractors were paid for fictitious projects – a central internal unit is to be established in the Office of the President and Cabinet. This unit will receive copies of internal audit reports and should, in principle, be able to oversee implementation of internal auditors' recommendations. However, this dual subordination is likely to further marginalise the internal auditors, who may come to be seen as an extension of the external audit department rather than part of the accounting officer's team.

The centralisation of the internal audit function is symptomatic of a financial management system in which the MFEP's has little confidence in agencies' accounting officers' willingness to follow and enforce financial management procedures. Enforcement requires political level commitment, and willingness to sanction and surcharge accounting officers where they fail to comply, as is provided for in the Finance and Audit Act. While MPEP's reform strategy indicates that it will impose sanctions (MFEP's, 2000), there is, as yet, little evidence of this.

Given the weakness of internal governance structures, the wisdom of maintaining the decentralised financial management system introduced in 1988, should be questioned. A central payments system – as recently introduced in Tanzania and Uganda and such as existed in Malawi before 1988 – is likely to offer much tighter controls, by providing an opportunity for a third party (the Accountant General) to pre-audit expenditures. Although this option was suggested in the Public Expenditure Management Review, it appears to have been given little consideration (World Bank, 1995: ix). Once the IFMIS is in place, consolidating the decentralised payments system, the option will no longer be available.

Improving cash-management

For planners and managers, a predictable flow of resources is crucial for planning and plan implementation. In Malawi, the in-year flow of funds has been unpredictable. Agencies' have received additional, unprogrammed funding in the form of extra-budgetary expenditures. Managers have also found their allocations cut in-year, either to accommodate changes in allocations between agencies or within the agency, or through the imposition of cash-budgeting. As in Tanzania, rigorous cash-budgeting proved an effective tool for bringing aggregate expenditures in line with resource availability in the short-term, as in 1996/97. However, the costs of cash-budgeting should not be underestimated. In-year cuts have fallen disproportionately on operating expenditures, since

statutory expenditures and personnel costs are fixed, and those institutions which are considered low priority. When the Government imposed cash rationing in early 2000, for instance, funds release for operating expenditures by some agencies were reduced to 10% of the budgeted amounts. Since agencies have tended to allocate the limited funding available to ensure maintenance – and sometime continued expansion – of core administrative expenditures, much of the burden of in-year stabilisation has fallen on field level and service delivery functions. Furthermore, where expenditures are tied to revenue yield, resources have not always been made available at the time needed for programme implementation. Funding for school materials, for instance, may be released after the beginning of the school year.

The solutions proposed in MFEP's reform programme, namely improved forecasting of resource availability and cash planning, cannot resolve these problems. As Table 2 demonstrates, revenue outturns have usually exceeded forecasts, other than in drought years. Forecasting of grants has proved more difficult, though, where a substantial part of these grants are for project financing, these expenditures are likely to self-correcting, since project expenditures will generally be determined by resource availability. Problems have tended to arise on the expenditure side, owing to uncontrolled spending, poorly programmed civil service pay rises, and higher than anticipated levels of inflation, domestic interest rates and depreciation of the kwacha. All of these factors have contributed to unprogrammed increases in expenditure and have increased compression on operating expenditures, as personnel and statutory expenditures have taken a larger than programmed share of spending. Ultimately, a predicatable flow of resources can only be ensured once the economy has been stabilised, since, by ensuring compliance with aggregate spending targets, it is more likely that macro-economic variable will remain in line with the plan.

If macro-instability persists, cash planning is only likely to improve predictability in those sectors that can be protected from in-year cuts by ring-fencing their programmes – as through the proposed Priority Poverty Expenditures (see Section 5.3). However, this is likely to increase compression in non-priority expenditures, for which funds delivery would become even more unpredictable. A more radical solution would entail programming resources at a guaranteed level of financing, so that agencies could programme a budget base, with additional resources being made available if higher levels of revenue and grant financing become available, through in-year Supplementary Budgets. Since agencies fail to respect budget ceilings during budget preparation at their current, higher levels, this approach is likely to encounter resistance.

Changes could also be made to way in which the budgeting system accommodates inflation. At present there is no explicit adjustment, so that inflation risks are effectively passed on to line agencies, who must adjust the volume of services provided to accommodate higher than anticipated price rises. Constitution of a centrally managed contingency reserve for inflation would provide some protection for key sectors, but providing for this would also imply reducing allocations at the beginning of the budget process. Clearly, these kinds of technical measures are no substitute for effective expenditure controls and budget management practices.

5.3 Strategic prioritisation and resource allocation

The World Bank's Public Expenditure Management Review, undertaken in 1994/95, revealed serious shortcomings in processes of strategic prioritisation and resource allocation. These problems stemmed, in large measure, from the inadequate articulation of the dual recurrent and development budgets.

Budget reforms in 1987/88 had put in place a programme classification for the recurrent budget, providing the basis for disaggregated programming and analysis of expenditures according to the

functional responsibilities of administrative departments in most Ministries, broken down by cost centres at the sub-departmental and district level. This is, potentially, a powerful tool for ensuring consistency between resource allocations and developmental priorities. However, despite the reforms in budget structure, budgeting continued to be seen as the exclusive responsibility of the Treasury and remained largely incremental, paying little attention to the activities and outputs that expenditures were supposed to support. Furthermore, budgeting continued to focus exclusively on the budget year and so was not linked to longer term development goals.

In contrast, the Public Sector Investment Programme (PSIP), introduced by the Ministry of Economic Planning and Development in 1989, provided a medium-term framework for the development budget and explicitly linked resources to developmental priorities through multi-year limits. However, these limits were only applied to the domestic financing. In practice, expenditure decisions were made bottom-up, through a procedure for vetting agencies' project proposals coordinated by the MEPD and Treasury. Although criteria for assessing policy relevance were developed – such as the criteria based on poverty reduction goals introduced in 1996 – these were never rigorously applied.

Coordination between the recurrent and development budget proposals was hampered by the separation of institutional responsibility for their formulation, and differing classifications and time horizons. Owing to constraints on the recurrent budget, agencies shifted an increasing share of their operational costs to development projects. Furthermore, generous donor financing of the development budget, led to situation where investment drove recurrent expenditures regardless of resource availability, and so 'contributed to fiscal stress through systematic budgetary overload' (World Bank, 1995a: 10).

Solutions were to be found, the Expenditure Management Review argued, in the consolidation of resource programming instruments at the core government and sectoral levels, through the introduction of the Medium Term Expenditure Framework and Integrated Sector Programmes (see Section 5.4). Development of these instruments began in 1995, supported, as in Ghana and Tanzania, by the introduction of an activity-based budgeting system at sectoral level. These reforms marginalised the PSIP. Although the responsibility for the preparation of the investment programme was transferred to the new Ministry of Finance and Planning and the programme continues to be prepared each year, little attention is now paid to monitoring of individual projects or the programme as a whole. Clearly, from an early stage, there was strong commitment to the MTEF and associated reforms, and a willingness to jettison existing systems and procedures.

In the early years, Malawi's MTEF was seen as a model, which other countries – Mozambique for example – were encouraged to emulate. Subsequently, Malawi's MTEF stalled. Sector programmes, the second pillar of the 1995 reform strategy, have also proved much more difficult to establish than was originally anticipated. More recent reforms, still at their formulative stages, have sought to introduce an output orientation to the budget and establish mechanisms for ringfencing priority expenditures. This experience is examined in greater detail below, identifying the principal weaknesses of the reform programme and possible solutions.

The MTEF and activity-based budgeting

The key feature of Malawi's Medium Term Expenditure Framework is its bottom-up approach, whereby the expenditure allocations are determined by assessing the trade-offs between costed sectoral expenditure programmes, elaborated using activity-based budgeting, rather than top-down through centrally determined expenditure limits. Initially, this was seen as one of the strengths of Malawi's MTEF (Campos and Pradhan, 1996: 33). Now it is recognised as its principal weakness.

Activity based budgeting (ABB) is supposed to ensure that resources are allocated to activities leading to the production of outputs, rather than institutions, thereby providing the basis for informed decisions regarding the costs and benefits which can be used to rank activities in order of priority. MoF worked closely with key sectoral ministries – starting with five priority ministries in 1995/96, twelve in 1996/97 and all ministries and departments by 1997/98 – to agree core functions, define mission statements, identify key outputs and the activities needed to deliver these outputs through a logical framework and then costing the activities in detail. Some progress was made in making sectors think critically regarding priorities. However, the impact of activity based budgeting on sectoral resource allocation decisions has been limited. A recent MFEP review of the MTEF experience has argued that 'it is unlikely that the reallocation of resources has been the result of improved information on the costs or benefits of different expenditure programmes. Indeed, it would appear that it has been executive decisions at Cabinet level – influenced by broader strategic and political considerations – that have driven the process of resource allocation' (MFEP, 2000: 11).

The limited impact of the MTEF and activity-based budgeting system may be ascribed to design weaknesses, aggravated by the difficult institutional environment in which the system was implemented. These include:

- Lack of policy-level engagement and commitment. The MTEF has been seen as a technical exercise, rather than as a tool for resource planning at a political level. Cabinet involvement in the review and approval of the resource envelope and resource allocations has been minimal. This is partly a result of the bottom-up approach, which meant that decisions regarding resource allocations continue to be taken at a late stage in the budgeting process, during bilateral, technical level negotiations between the MFEP and sectoral agencies. It is also a consequence of the Government's unwillingness to commit itself to hard resource constraints during budget preparation and execution, let alone over the medium-term, which undermines the rationale for forward planning.
- Weak medium-term perspective. There has been considerable reluctance on the part of MFEP and sector Ministries to move to a medium-term programme: the first medium-term programme was prepared in 1999/00, and this is little more than an extrapolation of the annual budget. MoPF provides an annual budget limit and asks agencies to programme over the outer years of the MTEF at a constant level. Inevitably, agencies have little interest in preparing detailed budgets for two to three years ahead where there is no firm commitment regarding resource availability.
- Focus on detail rather than strategic considerations. Attention has focused on detailed listings of inputs for each activity and their cost. This tends to distract attention from broader strategic considerations, such as the policy relevance and effectiveness of programmes, reducing the MTEF to a costing exercise. Moreover, in the absence of explicit criteria for appraising alternative activities, more detailed information on the structure of expenditures did not necessarily facilitate – indeed may have undermined – analysis and decision-making regarding priorities. Indeed, the underlying premise that it is possible to prioritise between activities is rarely true; most government agencies are required to undertake a range of activities and must accommodate resource constraints by reducing the volume of goods and services provided rather than eliminating the activities altogether.
- Incomplete expenditure coverage. Both the MTEF and activity-based budgeting focused on spending on goods and services, which account for a small proportion of total spending, and, during the initial stages at least, excluded personnel and development budget expenditures. As a result the scope for reallocating resources was limited and it was impossible to assess trade-offs between expenditure components. While the focus on operational costs makes sense in the short-term, since these are the most fungible items, it seriously undermines the system's usefulness as a tool for strategic prioritisation at a

sectoral level by preventing integrated analysis and programming of spending on personnel, investment and goods and services.

- Failure to link the MTEF exercise to budget and accounting systems. ABB was imposed on top of an existing budgeting and accounting system based on institutions (loosely structured by programme), without clarifying how information structured by activity would be compiled. Without computerised budgeting systems, the compilation of detailed activity costings into a comprehensive agency budget has proved impossible. As a result, agencies continued to compile their budget submissions according to the formal institutional and input classifications, often with limited input from the ABB exercise. Furthermore, because accounting officers were not involved in the design or implementation of the ABB, accounts continued to be rendered solely on the basis of the formal classifications, so that the ABB lacked any effective feedback on financial execution. As a result, the MTEF continues to be seen as a separate from the budget process.
- Weak linkage to operational decision-making. Detailed ABB makes sense where budgets are used as a tool in operational management by line managers. Some sectors, notably MoEST, rolled-out the planning and budgeting exercise down to individual cost-centres, and thereby ensured managers' involvement in budgeting. Most sectors did not: budgeting remained the responsibility of specialist budgeting and planning departments with minimal involvement of line managers. This was partly because the reforms focused on the technique, without establishing an institutional structure in which the ABB could be used. Sectors were encouraged to establish budget committees, in which operational managers would have a role in decision-making, but these committees are only operational in a few key Ministries and do not always comprise senior personnel.
- Needs-based rather than resource-constrained planning. Expenditure ceilings provide an essential framework for detailed budgeting at the sectoral level. Unfortunately, ceilings have tended to be communicated too late to be used as the basis for agency budgeting, and when these ceilings have been provided they have rarely been broken down internally so as to guide operational departments involved in budget preparation. As a result, budget proposals have tended to exceed MoF limits and have then have to be cut back, either during preparation or during execution. Inevitably this undermines the rationale for detailed budgeting, particularly when the detailed budgets are not adjusted to take account of cuts or cuts are imposed across the board. This reflects a more fundamental problem: the persistence of needs-based budgeting, by which agencies consider their budgets as part of a bidding exercise and so tend to ignore MoF limits when these are provided.
- Weak linkages to on-going public sector reforms. The initial steps in the preparation of ABB (identification of core functions and preparation of mission statements) mirror those of the OPC's Functional Reviews. However, there was little or no co-ordination between these reform efforts. Inevitably, this led to confusion, with conflicting policy priorities, and limited the effectiveness of both reforms. Similarly, the ABB was imposed as a single solution, ignoring initiatives by some sectors to develop new management systems through Integrated Sector Programmes that may have had other requirements for financial management.

The shortcomings of the MTEF exercise are recognised in Malawi, though there is, as yet, no consensus regarding the way forward. A review was undertaken by the MFEP with key line agencies leading to the formulation of an action plan in August 2000. Recommendations presented in the action plan include: improvements in the presentation of budget information to Cabinet and Parliament, focusing on policy and strategic issues; improvements in resource forecasting; a move over to hard-constraints, on the basis of a resource allocations defined top-down; and implementation of periodic expenditure reviews, in order to provide information regarding resource use and the effectiveness of government programmes.

All of these measures are intended to strengthen the MTEF as a tool for strategic prioritisation and resource allocation, linking the MTEF to the budget process. However, the plan has yet to be approved. In the meantime, the MTEF continues to be marginalised by decision-makers during the budget process and in the preparation of key planning instruments such as the PRSP (see Sections 2.3 and 4.3).

Output presentation of the budget

Documents submitted to Parliament for the 2001/02 budget exercise included, alongside budget estimates by institution, programme and input, an 'output presentation' of the budget. Based on South Africa's budget format, the output presentation attempts to structure expenditures by programme – broadly following the 1987/88 recurrent budget classification – and links programmes to specific outputs in terms of service delivery. Although the coverage and consistency of the 'output budget' is still poor, and the compilation is inconsistent with other budget documents, it could provide a much more useful basis for analysis by core government than the detailed ABBs.

However, the present 'output budget' is, essentially, a cosmetic measure, since the budget preparation process and criteria for budget contestation have not changed. If MFEP is to carry this reform forward, greater attention will need to be paid to the negotiation of key performance indicators and targets at the agency level. MFEP will also have to develop specific criteria for budget contestation, focusing on the relationship between expenditures and outputs. This would imply a significant change in the relationship between MFEP and line Ministries. By focusing on outputs, MFEP would be required to assess agencies' performance rather than merely verify their compliance with agreed allocations. This requires a move towards a contractual model, in which agencies agree to deliver specified outputs in exchange for a specified budget allocation. Ultimately, agencies would have to be given greater autonomy in their internal management, including the composition of inputs and rates of pay for personnel, if they assume responsibility for the delivery of outputs.

It is unclear how far MFEP intends to proceed in this direction, or how far it can proceed without fundamental public sector reforms, since the agency model would imply a relaxation of centralised controls on recruitment and civil service pay. Furthermore, the current financial management system is unable to deliver a predictable flow of resources that is a prerequisite in the contractual model. Nor are agencies' systems of internal control adequate to warrant a relaxation of MFEP's oversight over inputs. Nevertheless, a gradual move towards 'output budgeting' is attractive, not least because it would provide stronger support to target-driven approach advocated in the Poverty Reduction Strategy Paper.

Priority poverty expenditures

Priority Poverty Expenditures (PPEs) were first identified in the document 'PRSP Findings to Date', prepared by the PRSP Technical Committee as an input to the budget process and issued in May 2001 (PRSP-TC, 2001). Following the practice in Uganda, the intention was to designate key poverty reduction expenditures, constituting a virtual fund within the budget, which could be monitored through the quarterly reports on budget execution to ensure that these expenditures were protected from in-year cuts and reallocations. Thirteen PPE's were identified, including, for instance, funds for teacher training and medical supplies.

This concept had widespread support amongst donors and civil-society organisations, who regarded the PPEs as a safeguard that funds released through HIPC would be applied in poverty reduction

programmes. Since the PRSP Technical Committee included representatives from MFEP, it was generally expected that the PPEs would be clearly identified in the budget documents submitted to Parliament. They were not. Although some of the PPEs could be traced in the budget estimates or the 'output presentation', there was no systematic identification of the PPEs or the proposed application of HIPC funds. In response to criticism from the Budget and Finance Committee, the Minister of Finance's closing speech indicated the broad allocation of HIPC funds to date and promised that those funds that had not yet been allocated would be assigned in a Supplementary Budget in late 2001. The Minister also assured Parliament that 'there are elaborate funding procedures for the activities which are separate from the normal funding of government operations' and that these HIPC funds would be monitored separately (MFEP, 2001a). Exactly how this was to be achieved was not explained. No mention was made of the PPEs.

Notwithstanding the PRSP Technical Committee's support for the concept of PPE's, there is resistance elsewhere in the MFEP. Technicians doubt the practicality of ring-fencing certain expenditures, since, where there are short-falls in aggregate revenues, this will inevitably increase compression in those sectors that are not protected. They also question the practicability of capturing information on actual expenditures for programmes that are not presently defined in the chart of accounts, especially on a quarterly basis. Nevertheless, given the unpredictability of financing, weaknesses of the budgetary controls and consequent risk that priority programmes can be cut in year, the concept of PPEs remains attractive. If the principle is to be put in practice, however, clear procedures are needed to ensure effective accounting and monitoring.

5.4 Integrating external assistance

Aid inflows to Malawi doubled in real terms from 1975 to 1998, with the level of aid dependency rising from 9% to 26% of GDP over this period (IMF, 2001). In 1999, development assistance accounted for 40% of recurrent expenditures and 80% of development expenditures (MFEP, 2000). Such high levels of aid dependence have inevitably given rise to concerns regarding the macro-economic impact of aid and its consequences for the reform agenda. For the IMF (2001), aid has induced changes in public and private sector demand, has exerted persistent upward pressure on the exchange rate and, owing to the lack of adequate controls on domestic liquidity, has contributed to inflation. The IMF also argues that a substantial part of the aid inflows has gone to support recurrent budget outlays, rather than productive investments, and that aid has allowed the government to sustain poor policies, postponing the implementation of reforms. While there is growing recognition of these problems, most donors accept that Malawi will remain aid dependent in the medium and long term. Consequently, attention has focused on how to improve the effectiveness of aid and its consistency with developmental objectives.

The Government's aid management strategy has been geared towards resource mobilisation. Since the late 1980s, aid management has been the responsibility of a specialist department, organised in regional and multilateral-teams so as to facilitate negotiations with donors, first in the National Economic Council, and from 1997, in the MFEP's Aid and Debt Management Department. The PSIP was supposed to ensure that external financing was programmed in line with development priorities and integrated in the budget. However, the aid management system was undermined by the lack of a comprehensive database of financing agreements, the negotiation of financing programmes with donors outside of the budget process and line agencies' bilateral negotiations with donor agencies, so that project agreements were sometimes signed without informing core ministries and little information was made available on project execution. Furthermore, information sharing between the aid management and budgeting departments was – and remains – haphazard, with no common project and financing agreement codes to facilitate the consolidation of information on aid commitments and disbursements collected from donors and line agencies (OPC,

1999). As a result, it proved impossible to integrate aid into the budget: according to MFEP, at least 40% of aid inflows remain off-budget.

By the mid-1990s, donors had become acutely aware of these problems and their consequences for aid effectiveness. With over 600 donor-financed projects in the PSIP, a high proportion of which were concentrated in a few key sectors, it became increasingly difficult for the government to track, let alone guide, development assistance. Most sectors cite cases of projects with overlapping objectives and conflicting agendas. Furthermore, 'donors increasingly sought to compensate for the weakness of the domestic budget through projects and by other means', leading to a multiplication of parallel systems, contributing to lax controls and undermining limited national capacity (World Bank, 1995a: 10).

Solutions to these problems have been sought at two levels: firstly, through the development of integrated sectoral programmes; and secondly, through a shift from project aid to budgetary support. For the most part, these initiatives have been driven by donors, building on the experience of neighbouring countries. Progress in implanting these mechanisms in Malawi has been slow.

Integrated sector programmes

Integrated sector programmes were seen as a solution to the multiplication of donor-led projects in key sectors, leading to the diversion of resources from high priority activities and weak service delivery orientation. The intention was to formulate clear sectoral policies and strategies for service improvement and expansion, on the basis of a consensus with key stakeholders – and financing partners in particular – and then programme both external and internal resources simultaneously, thereby ensuring closer policy consistency of donor inputs. Ideally, donor support for the sector programmes would be provided as budgetary support, so as to allow greater flexibility in supporting activities and inputs that would have greatest impact on sectoral performance. However, the sector programmes would also provide a more coherent framework for project aid. By involving non-governmental partners in programme design, the sector programmes were expected to encourage partnership with non-governmental service providers, reducing the burden on the public sector.

In 1996 the World Bank indicated that, by 1999/00, its support to the education, health and agricultural sectors would be channelled through integrated sectoral programmes and that similar initiatives would be underway in other sectors (World Bank, 1996). This has proved overambitious.

Health and education medium-term sector plans were finalised recently (MoHP, 1999; MoEST, 2000). The education sector plan is particularly impressive, providing a mission statement, policies and strategies, with clear targets, for cross cutting themes – access, equity, quality, relevance, management, planning and finance – at each level of education. Unfortunately, both plans were prepared without firm expenditure ceilings over the medium term and with limited involvement or commitment by the MFEP. Consequently, resource forecasts may prove unrealistic, putting in question the plans' viability. The sectoral ministries appear to have opted for ambitious resource targets as a negotiating ploy, as a means of putting pressure on MFEP and donors to increase financing. In the short term this appears to have had the desired result: MFEP claimed to have increased its allocations to the health sector in 2001/02 because it presented a coherent plan and budget. However, even with good-will on MFEP's part, the margins between programmed and actual financing are likely to widen significantly in the plans' outer years.

Little progress has been made in the agricultural sector. Preliminary discussions on the Malawi Agricultural Sector Investment Programme started in 1994, but debate regarding the scope and components of the programme is still on-going (MASIP, 2001). Responsibility for the formulation

of MASIP has been passed from the Ministry's planning department to a MASIP office, based outside the Ministry and staffed by contracted personnel. This was justified on the grounds that MASIP extends beyond the Ministry, embracing a wide range of non-governmental actors. Much of the work of the MASIP unit has, in fact, involved stakeholder consultations. However, as a result, in-line personnel show little commitment to MASIP, which is seen as a discrete programme, separate to the Ministry's day-to-day work. Some departments, such as the extension service, have taken the initiative in formulating strategies, but these are not linked to a vision and strategy for the sector as a whole (MAI, 2000). There appears to be no consensus regarding the solution to this impasse, though donors are clearly impatient regarding the lack of progress and continued poor performance of the Ministry of Agriculture, particularly following the PER's revelation that 70% of Ministry of Agriculture's budget was spent in the Ministry itself.

While the preparation of integrated sector programmes is, ultimately, a sectoral initiative, it is clear that the MFEP should play an important role. If plans are to be realistic, they must be based on an agreed resource envelope, integrated into the MFEP's forward planning instruments, such as the MTEF. Furthermore, if sector programmes are to rolled-out across government, a strategy has to be put in place for providing the necessary support. So far, the MFEP has failed on all these counts. The recent PER process may provide an opportunity for making up for lost ground, by involving MFEP in fundamental reviews of sectoral strategies and thereby providing the basis for discussions at a policy level.

For donors, delays in the formulation of sector strategies and programmes have hindered the implementation of new aid delivery mechanisms. The World Bank's 1998 Country Assistance Strategy, for instance, recognised that 'development of well-coordinated sector strategies and investment programs would require more time that previously anticipated' (World Bank, 1998: 22), and argued that sector investment programme-type operations would have to be used instead, such as APLs and Learning and Innovation Loans. Although basket financing mechanism, using harmonised but parallel procedures, are being developed for the education, health, safety nets and agriculture sectors, most donors continue to rely heavily on project aid.

Moving towards budgetary support

The Public Expenditure Management Review of 1995 advocated an increase in recurrent budget support, in order to support recurrent expenditures for an expanding network of social services, extension services and rural transport infrastructure (World Bank, 1995: v). Given the poor compliance in Malawi's public expenditure management system, Malawi is an unlikely candidate for grant-financed budgetary support. However, in recent years, four donors (Sweden, Norway, Denmark and DFID) have sought to use budgetary support as a means of supporting the expansion of service delivery, while at the same time providing an incentive for the Government to implement public expenditure management reforms. Under the Common Approach to Budgetary Support (CABS), the four donors negotiate an annual disbursement programme – on the basis of annual commitments by Sweden and Norway, and three-year programmes for Denmark and DFID – in support of an agreed programme of reforms in the area of public expenditure management, as proposed by Government. Disbursements are programmed quarterly, following a quarterly review of progress against the reform programme. As yet, disbursements have been delivered as programmed, though delays have occurred, as in early 2001, owing to the Government's postponement of review meetings.

Assessment of CABS' effectiveness as an instrument for driving reform differ. MFEP sees CABS as the preferred model for aid delivery. However difficulties have arisen in agreeing a reform agenda, in the absence of a comprehensive reform strategy for the Ministry, not least because

negotiation with participating donors is primarily the responsibility of the Aid and Debt Management Division, while most of the reforms have to be implemented by other departments. Donors have indicated their disappointment at progress in reforms, though this has yet to provoke disruptions in the flow of funds. This may partly be because donors are reluctant to suspend a substantial part of their development assistance to Malawi for fear of internal budgetary implications the following year. It is noteworthy that other donors have yet to participate in CABS, though Germany and USAID do participate in quarterly meetings as observers.

6 Information and Analysis

6.1 Poverty monitoring and analysis

A Poverty Monitoring System was established in 1996, in order to provide information for policy formulation and monitoring. The PMS is coordinated by the National Economic Council and overseen by a Technical Committee, comprising representatives of government departments, research institutions, donors, community service organisations and the private sector (PMS, 2000). A monitoring strategy has been developed and applied, embracing a wide range of surveys implemented on a regular cycle (see Table 3).

Household surveys are the principal source of information for policy purposes, covering household consumption, income sources and information on the socio-economic characteristics of the poor. Analysis of data from the 1997/98 survey has been used to prepare a poverty profile and identify key correlates and determinants of poverty (NEC, 2000 and 2001). This will be followed up by a panel survey on a small number of households over an extended period, in order to improve understanding of why families move in and out of poverty. A Core Welfare Indicators Questionnaire is to be introduced so as to provide monitoring information, from a large household sample, on an annual basis. Supplementary quantitative information is gathered through the national census and specialist surveys, usually undertaken to provide sector-specific data, such as demographic and health surveys, agricultural surveys, and social indicator surveys. The PMS also undertakes Qualitative Impact Assessments, through semi-structured interviews at the village level, to assess the poor's perceptions the causes of poverty, poverty trends, priority interventions, governance, access to services and the impact of poverty policies (NEC, 1998).

Table 3: Poverty Monitoring Instruments

	First	Most Recent	Planned Frequency
Integrated Household Survey	1990/91		3/5 Years
Demographic and Health Survey	1992	1996	5 Years
Agriculture Sample Survey	1992/93		10 years
Qualitative Impact Monitoring	1997	2000	3 Years
Census		1998	10
Core Welfare Indicator Questionnaire		2001	Annual

There is no scarcity of poverty information. Capacity constraints within NEC have meant that analysis tends to depend heavily on external technical assistance – IFPRI, for instance, played the leading role in the analysis and publication of the results of the 1997/98 Household Survey – a situation that is likely to persist in the medium term. The principal problem encountered is to ensure that poverty analysis feeds into the policy formulation and planning process. Most informants in MFEP and line ministries showed little awareness of the results of poverty analysis and their implications. Nor is there evidence to suggest that reports have been studied at Cabinet level, and certainly reports are not approved at this level before publication.

The PMS has sought to disseminate its analytical reports widely throughout government, and prepares short policy briefs giving a summary of key results. However, the emphasis in much of the PMS documentation is on analysis, some of which is technically complex – there is pressure on international experts to generate reports that will be academically credible – and so is difficult to interpret for non-specialists. PMS reports have avoided presenting policy prescriptions or clear

statements of the policy options and their relative merits, which has made it difficult for planners and policy to assess their implications. Clearly, there is a need for a stronger interface between analysis and policy making, though this inevitably requires different skills and areas of expertise and is likely to prove difficult where reports are written by expatriates, who may be reluctant to adopt a prescriptive tone. The recent appointment of a Minister for Poverty Alleviation may help resolve some of these problems, by providing a channel through which to raise policy issues at the Cabinet level. The establishment of thematic working groups under the PRSP, including participants from donor agencies and the academic community, who are more likely to be informed about and able to use poverty analysis, may also increase the likelihood that analysis is used in policy making.

The monitoring framework defined by the PRSP-TC (2001a) includes a range of medium and short-term indicators designed to capture various dimensions of poverty, including consumption, food security, literacy and educational attainment, health, environmental degradation, and a composite welfare indicator. Large surveys are suitable only for monitoring trends and policy impact over the medium term. Greater emphasis will have to be placed, therefore, on the collection of information from administrative sources and surrogate indicators such as crop estimates and price surveys. Some of these information systems are already in place, though there are concerns regarding the reliability of some administrative sources which have become tainted by false declarations of service delivery levels. Work has already begun in some sectors; the Ministry of Education, for instance, is currently undertaking a school mapping exercise, which will provide the basis for a revamped data collection system (MEST, 2001). Key poverty reduction indicators at the institutional level could provide the basis of a performance-management system at the institutional level and criteria for budget contestation. These linkages are explored below.

6.2 Public expenditure analysis

Until recently, public expenditure analysis has been limited to the routine review of agency budget proposals and project cycle management. Treasury circulars indicate that agency budget proposals will be assessed in terms of compliance with expenditure ceilings and economy, efficiency and effectiveness in the use of public funds (for example, Treasury Circular Instruction 6 of 2000/01). No specific criteria are presented for this kind of analysis, though the circular does request agencies to provide details of historical trends in programme outputs. In practice, agency reporting on performance information is poor and budget analysis tends to focus on compliance with limits and the structure of inputs, particularly programmed increases in personnel and administrative expenditures. Owing to delays in the consolidation of agency accounts, little information has been available for assessments of expenditure outturns, other than the aggregated information made available in the agencies' budget proposals. Given the time, information and capacity constraints, there is little opportunity for fundamental analysis of the policy relevance of expenditure, let alone more specific analysis of efficiency and effectiveness.

In the early 1990s, analysis of the development budget and individual projects was more sophisticated. Projects were, in principle, subject to appraisal prior to their inclusion in the Public Sector Investment Programme. In 1996, specific criteria were formulated to assess a project's consistency with poverty reduction goals, through these were never applied systematically (GoM, 1996: 9). NEC prepared an annual review of the investment programme and the performance of individual projects, in order to identify cost and time overruns; poorly performing projects were cancelled. With the introduction of the MTEF, however, PSIP procedures were abandoned; in 2000/01 neither the PSIP nor the annual programme review was published.

The MTEF should have provided an opportunity for a more comprehensive and strategic analysis of public expenditures at the sectoral level. However priority was given to improvements in the formulation of expenditure programmes, so that MFEP analysis of agency MTEF submissions focused on methodological compliance rather than expenditure analysis. As a result, the MFEP has, in effect, been steering public expenditure without maps, having little understanding of how funds are actually applied, their consistency with government policy and the relationship between agency expenditures and outputs.

In this context, the public expenditure review undertaken by MFEP in late 1999 and early 2000 marks a important step forward. Unlike the 1990 PER, which was led the World Bank and seen by some senior figures as a hostile process – the World Bank's proposal for a second review in 1995, as a follow-up to the Budget Management Review, was turned down by the MoF – the second review was a largely internal exercise, undertaken by MFEP and sector ministry staff with some World Bank support. Focusing on the four priority sectors (education, health, agriculture and works), the review assesses the policy consistency, efficiency and effectiveness of sectoral spending and provides recommendations regarding expenditure management and resource allocations (MFEP, 2000). Although the quality of the review is patchy – the analysis of the agricultural sector is particularly weak, lacking a critical analysis of current spending patterns and failing to draw clear conclusions for reform – MFEP ownership is strong. A number of recommendations from the review were subsequently incorporated in the 2000/01 budget, such as increases in the allocations for teaching materials and inspection, aimed at providing $2.50 materials for each student, more equitable funding in secondary schools and an increase in allocation for drugs to over $1.16 per capita (MFEP, 2000a).

The challenge is to transform the Public Expenditure Review exercise from a one-off study into an expenditure analysis routine, providing support to expenditure policy making during the budget process. There has been some discussion within MFEP regarding a follow-up to the PER, though no decision has yet been taken. One option under consideration is a move to an annual PER, such as is now the practice in Tanzania and Uganda, possibly as a two-stage process, the first stage providing an overall review prior to the preparation of Budget Guidelines, and then mid-way through the year to guide budget revisions (MFEP, 2000). An alternative, would be to have a core annual PER, focusing on broad expenditure allocations and key sectors, supplemented by periodic sectoral PERs, on a multi-year cycle for the remainder of government.

The Tanzanian and Ugandan approach also suggests a different composition of the teams involved in PER preparation, including a wider range of donor representatives and consultants. While this may improve transparency and donor confidence, there is a danger that the PER will come to be seen as a donor exercise rather than an internal government routine. The 2000 PER illustrates these risks: although the government personnel were involved in drafting the report and carrying out part of the analysis, the World Bank has prepared alternative drafts of some of the weaker chapters and there is some discussion as to which of the drafts should be presented in the final document.

While detailed expenditure analysis undertaken in PERs is primarily intended as a support to policy formulation and monitoring, it can also support more operational budgeting functions. At this level, the design and application of budget contestation criteria is crucial. Where criteria are poorly defined – as in loose references to economy, efficiency and effectiveness or policy relevance – they provide little guidance to agency personnel in the formulation of their budget proposals or MFEP personnel when appraising these proposals. Recent steps towards the introduction of an 'output presentation' of the budget, together with the identification of key monitoring indicators for the PRSP, provide an opportunity to develop sector-specific measures of efficiency and effectiveness on which contestation criteria can be built. This would require the definition of key performance indicators for each institution at the output level, linked to the PRSP poverty monitoring

framework, and negotiation of annual performance targets. Contestation criteria can then be based around output and expenditure ratios at the aggregate level, using historical information as a benchmark, and performance can be assessed against trends and targets. In this way, the PER process can provide support to routine performance monitoring.

7 Oversight and Participation

7.1 Transparency in public expenditure management

The framework for fiscal management put in place under single-party rule and implemented during the early years of the multi-party regime provided for the publication and parliamentary review of budgets, annual accounts and an annual audit report. However, fiscal transparency was undermined by a number of factors. The budget was prepared behind closed doors, with information made available to parliament and the public only once policy decisions had been taken by the executive. While the budget presented information on recurrent expenditures by vote, programme and cost-centre and development expenditure by project., the lack of summary and multi-dimensional analysis hindered policy analysis, obscuring policy decisions regarding resource allocations in overwhelming detail. Policy analysis was also handicapped by the lack of forward estimates of fiscal aggregates and resource allocations.

Some information on the performance of and targets for public agencies was presented in the Economic Report, submitted to parliament alongside the budget, and in Treasury Memoranda, but there was no explicit link between expenditures and the outputs of public agencies. There was no public reporting in-year regarding progress in budget implementation, changes in resource allocations and fiscal aggregates were reported at the end of the budget year, through revised estimates presented in the following years estimates. Annual accounts were prepared with a time lag of about twelve months, as compared with the six months foreseen under legislation, and usually failed to relate actual expenditures to original and revised estimates. Audit reports were also produced with a significant delay, usually eighteen months after the end of the fiscal year.

With the introduction of the MTEF in 1995, the government sought to address some of the deficiencies in the presentation of budgetary information and reporting. Forward recurrent budgets were presented from 1997/98, though these are often little more extrapolations of the current year’s allocations, often at the same level of spending. More recently, during the 2000/01 budget exercise, the Government presented its first ‘Output Budget’, which is supposed to link expenditures to the outputs of sectoral agencies’ programmes. The Government has also published quarterly reports on public expenditure, through its web page.

Problems remain, particularly as regards:

- lack of summary and multi-dimensional analysis of public expenditures;
- frequent computational errors in documentation;
- poor compliance of sectors with MTEF and ‘output based’ budgeting methodologies;
- delays and lack of adequate detail of reporting; and
- failure to make explicit variance between approved and actual expenditures in budget and accounting documentation.

Nevertheless, progress has been made and on-going financial management reforms may resolve some of informational constraints underlying these deficiencies in transparency. Perhaps the most important are the attempts to open-up the policy making process launched by the current Minister of Finance. In the run-up to the 2001/02 budget exercise, the Minister undertook wide-ranging pre-budget consultations, engaging both parliamentarians and the broader civil society (see Section 7.3). A broader range of policy issues are identified in the Budget Speech, providing greater insight into the government’s short and medium-term policy objectives and fiscal targets. The Ministry has also begun to publish the minutes of the Monetary Policy Committee, providing monetary targets and assessment of progress against these targets. There is some discussion within the Ministry

regarding the introduction of a budget 'White Paper', an idea first mooted in 1997 and then abandoned, providing a preliminary statement of expenditure policy and resource allocations, which would provide a basis for future pre-budget consultations.

South Africa's budget reforms, which were the subject of several study tours by senior Treasury officials, are one inspiration for these initiatives, though clearly the Minister of Finance has been the driving force behind efforts to open-up the policy process. In the absence of a government-wide strategy for promoting open government, however, it is unclear to what extent these initiatives will be carried through to the sectoral level. Fortunately, pressure from civil society and parliament for more open government is likely to sustain the momentum of reform in the near future.

7.2 Legislative oversight of public expenditure management

In principle, legislative oversight over the Government's management of public expenditures is assured through the Auditor's General Office (AGO) and the work of the legislatures specialist committees, supporting plenary debate and votes on the State Budget and State Accounts. In practice, the effectiveness of the auditor's oversight function is undermined by its statutory framework, institutional constraints, poor enforcement of auditors' recommendations and the Government's unwillingness to discipline officials. Until recently, there was little scrutiny of the executive's budget proposals, with budget votes rushed through plenary debates after cursory and uncritical analysis by the Budget and Finance Committee. The Public Accounts Committee has been more active and confrontational, taking the Government to account where the auditor's reports have revealed evidence of malfinance and poor compliance with legislated expenditure limits. However, the legislature has faced considerable difficulty is enforcing its authority over the executive.

The role of the Auditor General

Provisions of the 1994 Constitution and the Finance and Audit Act, dating back to 1962, compromise the Auditor-General's independence from the executive. Under the Constitution, the President is empowered to appoint the Auditor-General for five year terms and may remove the auditor, on grounds of incompetence or financial impropriety. Parliament's Public Accounts Committee may 'inquire into' the Auditor's competence and probity, but otherwise has no role in his appointment or his removal. The Auditor General's reports are, moreover, submitted to Parliament through the Ministry of Finance, rather than directly. Although there is no suggestion that Auditor-General has been subject to undue political interference, recent reports have argued for new legislation, including separate Finance and Audit Acts, that would enshrine the Auditor General's independence (IMF, 2000: 24).

Delays in the presentation of Audit reports are a serious handicap to effective oversight, since this prevents timely corrective action and the investigation of corruption. Audit reports are supposed to be submitted to Parliament twelve months after the end of the fiscal year. Delays of eighteen to twenty four months are common: the report covering the 1998/99 budget had still not been presented to Parliament when the 2001/02 budget went to Parliament. This is largely due to delays in the finalisation in agency accounts, especially for donor-financed projects, aggravated by poor record keeping, and capacity constraints in the AGO.

Not only is the AGO constrained by staff shortages, it also suffers from high staff turnover, as trained staff leave for the private sector. These capacity constraints are likely to become more severe as the decentralisation process unfolds, increasing the number of institutions to be audited.

The decision to allow the AGO to contract auditors has alleviated these pressures, but, the AGO argues, a permanent solutions lies in the concession of agency status, which would allow the AGO to pay competitive salaries. As yet, there is no agreement on such radical reforms.

Notwithstanding these constraints, AGO's reports have been extremely critical of Government's financial management, identifying both systemic weaknesses and specific instances of malfeasance. The Report on the 1997/98 accounts, for instance, begins with an indictment of the system as a whole: 'The overall impression obtained during the course of audits was that Controlling Officers fail to strictly enforce budgetary control procedures through the process of the monthly expenditure monitoring system' (AOG, 1999: i). An AOG report on education sector identified widespread corruption in the procurement of works contracts, implicating politicians and senior officials.

Unfortunately, the executive's response to audit queries and observations is often poor. The head of the civil service, the SPC, is supposed to ensure that Principal Secretaries respond to audit queries and apply recommendations, but there is little enforcement. Parliament's Public Accounts Committee also has difficulty in enforcing discipline, sometimes encountering incomplete and evasive responses from the executive. Particular difficulty is encountered in bringing cases of malfeasance to trial. In July 1999, for instance, PAC complained at the delays in bringing those responsible for the Ministry of Education scandal to court (*The Nation*, 9th July 2001).

Budget discipline can only be enforced where there is strong political commitment and willingness to hold those that fail to follow correct procedures to account, by applying those sanctions provided for in the law and prosecuting those responsible for corruption. In the absence of this high-level commitment, it is unlikely that significant improvements in financial management can be achieved and the prospects for improved compliance are poor.

The role of the Legislature

Under single party rule and during the first years of the multi-party regime, legislative oversight over public expenditure management was a formality. There are a total of eighteen Parliamentary Committees, including a Budget and Finance Committee, a Public Accounts Committee and committees covering key sectors such as education, health and agriculture. Most of these committees have never met outside parliamentary sessions, which last for about eight weeks a year, largely because of insufficient funding: the National Assembly's budget for 2000/01, for instance, made provision for only 42 days of committee meetings. Furthermore, committees lacked adequate administrative support and access to technical specialists. In these circumstances it is hardly surprising that there is no tradition of referring issues to parliamentary committees for review.

The Budget and Finance Committee's scrutiny of Government budget proposals suffers from the same constraints as other committees, aggravated by the fact that budget documentation has usually been presented late, about two weeks before the budget is tabled for debate and voting, and deficiencies in budget information (see Section 7.1). The budget is approved, without amendment, by Parliament following a superficial review of the detailed budget documentation presented by the Budget and Finance Committee and a brief plenary debate on the Minister of Finance's budget speech, usually held at the beginning of the fiscal year. A revised budget, accommodating virement and excess expenditures, is presented in the following year's draft estimates for information purposes only, rather than as a formal Supplementary Budget as required by law. As noted above, the National Audit Office has presented its report to Parliament's Public Accounts Committee about eighteen to twenty four months after the end of the fiscal year – as opposed to the twelve months foreseen under legislation. The PAC has sought clarifications and presented recommendations

based on the audit report, though these recommendations have usually been followed-up the Office of the President and Cabinet rather than by PAC.

An initiative aimed at improving parliamentary scrutiny of the budget was launched during the lead-up to the 2001/02 budget exercise, within the framework of a programme of support to parliamentary committees launched in 1999, managed by the US based National Democratic Institute and financed by a consortium of donors. External funding has enabled the Budget Finance Committee to undertake pre-budget consultations with government departments, members of other parliamentary committees and nearly fifty civil society organisations. NDI also drafted a detailed and critical report on the government's budget proposals, that was subsequently submitted to the National Assembly, taking into account the concerns raised during consultations and written contributions solicited through newspaper advertisements after the tabling of the budget. The report includes an analysis of the broad allocations of resources, changes in real terms over the previous year's budget and an attempt to relate spending to outputs, where information is available. It raises concerns regarding the budget process and the allocations proposed by Government, particularly in relation to the inadequate budgetary discrimination and protection of HIPC financing for Priority Poverty Expenditures (see Section 5.3) and the low levels of funding proposed for oversight bodies (BFC, 2001).

Although this represents a significant improvement in the quality of legislative scrutiny of the budget and budget process, its impact on expenditure policy is – as yet – limited. Little opportunity was given for plenary debate: the 48 votes were reviewed and approved, without amendment, in just two days. Committee members failed to raise many of the questions raised in the report. Indeed, with the exception of the Committee chairperson, formerly a senior civil servant and MCP minister, committee members' understanding of public sector management issues remains weak.

Capacity-building activities planned by NDI can address some of these problems. However improved parliamentary scrutiny will also require procedural reforms, some of which were highlighted in the BFC's report. These include;

- **Pre-budget documentation:** Pre-budget consultations on public expenditure policy would be more effective if they were based on pre-budget policy documents, such as the proposed Budget White Paper, providing an overview of macro-economic and fiscal policy, the broad vote-by-vote allocations and allocations to key poverty reduction sectors. This would allow Parliament to influence the sectoral allocations at the beginning of the budget process, before budget ceilings are announced.
- **Presentation of budget documentation:** Although the introduction of an 'output budget', which should, in principle, link expenditures to output targets, marks a significant step forward, considerable work still has to be done in improving the presentation of budget documentation, particularly as regards the consistency of the information provided in support of each vote, the accuracy of the summary information, and the range of multi-dimensional and summary analysis. The current practice of presenting the bulk of the information in detailed estimates, running to four volumes and several thousand pages in the 2000-01 exercise, makes policy analysis practically impossible.
- **Adequate time for review and debate:** During the 2001/02 budget exercise, MFEP submitted detailed budget estimates only ten days before the budget debate. This was far short of the twenty-one days proposed by the BFC and too late for detailed review and consultations regarding the government's proposals. The time allocated for parliamentary debate was also inadequate, a problem aggravated by the Government's eagerness to run through the votes as fast as possible. While extension of the BFC's deliberations – which only lasted eight days in the 2000/01 exercise – and plenary debates has significant cost implications, parliamentary scrutiny is only likely to be effective when adequate time is made

available for review and debate. PAC has traditionally met for longer periods – forty days during 2000/01 – but this is still inadequate, since the committee is currently faced with a backlog of auditors' reports.

- **Supplementary Budgets:** Poor compliance with approved estimates undermines parliamentary authority over public expenditure, since resource allocation decisions are ultimately made administratively through the approval of extra-budgetary expenditures. Parliament can only reassert its authority by requiring the presentation and formal approval of Supplementary Budgets to accommodate virement and excess expenditures. Consolidation of the extrabudgetary expenditures for approval twice a year, rather than continuously as is currently the case, would allow a proper assessment of the trade-offs between expenditure proposals, and their macro-economic impacts, and would also act as a brake on the growth of expenditures.
- **Follow-up on Committee recommendations:** There are no effective mechanisms in place for the BFC and PAC to follow-up on recommendations made to government, a function that is currently assumed by the executive. In order for parliament to assert its authority over the budget process, the executive should present follow-up reports and resources should be set aside to allow the relevant committees to review implementation and question ministers on their performance. BFC's report proposes that the Committee should meet quarterly to review budget implementation reports.

7.3 Civil society, consultation and participation

Civil society organisations, led by the Public Affairs Committee, established by churches and professional bodies in the run-up to democracy, have consistently advocated a poverty orientation in public policy through their meetings with politicians and open letters. They have voiced particular concern regarding the impact of macro-economic policies, with the PAC calling on Government to ensure that its negotiations with IMF take into account the 'interests of the common man'. However, most Civil Society Organisations remain extremely conservative in their approach to poverty reduction. For them 'poverty is not a political issue, it is a personal problem unrelated to Malawi's class and political system' (Van Doepp, 1998: 113). Moreover, whilst criticising party bickering, the regionalisation of politics and the marginalisation of policy debate, Civil Society Organisations have not confronted Government over widely publicised cases of corruption and self-interested behaviour by politicians. Criticism of the Government's decision to award Ministers a substantial pay rise in 1996 and the purchase of a fleet of ministerial limousines in 2000 was muted. However, there are signs of a more progressive groups emerging within Civil Society Organisations, advocating empowerment and more critical of government policies.

Civil Society Organisations' interest in public expenditure management issues can be traced back to the Jubilee 2000 campaign, organised by the Catholic Commission for Peace and Justice, in conjunction with other church based organisations. In November 2000, these organisations established the Malawi Economic Justice Network in order to carry forward the campaign for full debt cancellation and ensure that civil society would be involved in the PRSP process and budget consultations, while co-ordinating activities aimed at increasing economic literacy.

MEJN has focused on the PRSP, which provides a framework for other advocacy issues and public information work, publishing a critical review of the PRSP process with updates in periodic newsletters (Magalasi et al, 2001; MEJN, 2001). Even though MEJN has only a small team, drawing on collaborators from other CSOs, it has been remarkably influential, particularly as regards the extension of the time frame for the PRSP process from two months to ten in order to allow opportunities for meaningful consultation and analysis (see Section 2.3). Subsequently, MEJN organised civil society working group discussions on the PRSP, to coordinate inputs into the

thematic working groups and monitor the extent of consultations. MEJN has also published a review of the 2001/02 Budget , which was extremely critical of the Government's failure to present details of Priority Poverty Expenditures and the proposed allocations for poverty reduction and governance institutions.

In marked contrast to the Banda regime, which was characterised by secretive and autocratic decision-making, the democratic government has actively involved civil society organisation and – to a lesser extent – the wider public in the planning process. The first national-level consultations were launched in 1996, when the Government began preparation of its long-term development strategy, 'Vision 2020', through public meetings at the national level, involving a wide range of civil society organisations, and meetings at regional and district centres. Since the Vision was intended as a consensus document, the final document was drafted by a core team, including representatives of government, business and academics (GoM, 1998). Further consultations have taken place during the Government's Policy Analysis Initiative, co-ordinated by OPC, in the preparation of the sector programmes and in pre-budget consultations during preparation of the 2000/01 budget. The Government has also opened up Consultative Group meetings, by allowing NGO observers. By mid-2000, when the Government launched the PRSP process, some civil society organisations were already beginning to complain of the 'excessive unfocussed consultation' and there was 'clear evidence of consultation fatigue and recognition that consultation does not necessarily involve participation in decision making' (GoM, 2000a).

To address these concerns, the PRSP process has involved only two public consultations, the first at the launch of the PRSP process, in order to inform key stakeholders, and the second at the very end, in order to validate the results of the process. Broad participation in the PRSP process has been achieved by allowing Civil Society Organisations to nominate participants in the thematic working groups, responsible for the formulation of the PRSP and encouraging the thematic groups to consult with a wide range of stakeholders.

Civil society organisations have participated actively in all Government organised consultations and have encouraged the Government to provide additional opportunities for consultation during the budget process, at Consultative Group Meetings and in policy processes, such as the PRSP. However, civil society organisations are beginning to question whether they are really able to influence policy, or whether the consultative process serves only as window-dressing for decisions which the Government would have taken anyway. One of the CSOs' criticisms is that the Government seeks to control the consultative process, discouraging independent analysis that may lead to public criticism. The Government's refusal to allow an independent CSO working group to review the draft PRSP thematic papers prior to the finalisation of the PRSP, arguing that this is redundant since CSOs have already been involved in thematic group discussions, is a case in point (MEJN, 2001a). This is partly a reaction to MEJN's aggressive criticism of the PRSP process (MEJN described the PRSP as 'a joke', a reference to which found its way on to the IMF website). However, it also reflects deep-rooted ambivalence towards Civil Society Organisations.

While the Government recognises that CSOs play an important part in the democratic process and service delivery, it also regards them as a threat, politically and economically. The role of church-based organisations in the transition to democracy demonstrated the extent of their political authority. At the same time the Government questions the legitimacy of these organisations, which are seen as representing specific constituencies rather than the country as whole. Economically, CSOs and NGOs, including international NGOs, are substantial service providers, particularly in the health and education sectors. Kalemba (1997:31) estimates that there are about 150 active NGOs in Malawi and quotes one study that gives their combined income as equivalent to the Government's budget. No doubt this is an exaggeration. Nevertheless, Government agencies are clearly concerned at the volume of external aid channelled through NGOs, which are seen as direct

competitors for scarce funding. Furthermore, Government agencies are acutely aware that the functional analysis undertaken in formulation of sector programmes, may imply a transfer of resources from the public sector to NGO providers. The Government's response has been to tighten its control over NGOs. The Government has encouraged NGOs to join CONGOMA, the NGO co-ordinating body, but membership is voluntary and not all NGOs are registered. A Bill has now been prepared establishing an NGO Board, with mandatory registration, together with provisions allowing closer coordination and supervision by Government.

8 Conclusion

Since the transition to democratic rule in 1994, the Government of Malawi has realigned public spending with its poverty reduction priorities. The social sectors were allocated an average of 37% of total public spending over the 1994/95 to 2001/02 period as compared with just 21% of spending in 1991/92. Increased spending has supported a massive expansion of primary education, following the introduction of Universal Primary Education in 1994, with the number of primary school students increasing by 50%. Enrolment in secondary education has also improved, with the number of students in conventional secondary schools doubling and in distance education colleges increasing fivefold. These impressive achievements are qualified, however, by a deterioration in the quality of education offered, owing to increased pupil teacher ratios and a fall in the proportion of qualified teachers. Improvements in access to safe water and family planning have also been reported. However, the coverage of other critical services, such as vaccinations, has deteriorated. While survey evidence confirms greater access to education and a slight decline in child mortality, other poverty indicators stagnated or deteriorated during the 1990s. There is little evidence for a decline in consumption poverty, but levels of stunting and wasting amongst children remained unchanged, while maternal mortality rates have increased significantly and life expectancy has fallen. The high incidence of HIV/AIDS is an important contributor to these trends. However, the continuing high incidence of poverty, with 60% of the population classified as poor and 29% as ultra-poor in 1997/98, can also be attributed to Malawi's poor economic performance during the 1990s. Per capita GDP growth averaged just 0.5% from 1989 to 1999.

Public expenditure management reforms were supposed to support the realignment of resources with policy priorities, notably through the introduction of a Medium Term Expenditure Framework and Integrated Sector Programmes. Significant resource reallocations were achieved in 1995/96, using the old, annual budgeting system, before reforms had started. However, there is little evidence that the MTEF was used in decision-making at a policy or operational level in later years. Indeed, the MTEF process remains largely divorced from routine budgeting and has not been used as the basis for the PRSP. Sector programmes have had a greater impact, though their formulation has taken much longer than originally anticipated. Programmes are now in place for education and health, providing a clear policy and strategic framework for expenditure allocation in these sectors. There is still little progress in the formulation of the agricultural sector programme, with continued debate regarding the role of the public sector in the delivery of agricultural support services. This may explain why public spending on agriculture has stagnated since 1994/95, despite the high priority accorded to agricultural development in the Government's poverty reduction programmes.

Notwithstanding progress in resource reallocation at a broad sectoral level, and at within-the sector level in education and health, there are fundamental weaknesses in public expenditure management systems. The most important of these relate to public expenditure control. Surges in public spending, during the 1994 drought and in the run-up to the 1995 and 1999 elections, have led to unsustainable increases in the budget deficit, financed in large part by domestic borrowing and the printing of money, leading to surges in inflation and the crowding out of private sector credit (see Section 4.1). Unprogrammed increases in spending have diverted resources to administrative services, reducing the share of available for social sectors and service delivery. Fiscal stabilisation has been achieved by cash-budgeting, leading to in-year shortfalls in funds' release. This too has favoured administrative capture of scarce resources, since agencies' have tended to protect administrative overheads and personnel expenditures. Owing to routine approval of extra-budgetary expenditures and weak expenditure controls, the budget has ceased to be a realistic predictor of resource availability: in any one year more than half of public institutions receive either 10% less or 10% more than originally programmed, and it is by no means uncommon for institutions to receive allocations that are 30% higher or lower than originally anticipated. This has undermined the

rationale for detailed budgeting, since additional resource may be negotiated during execution. It has also hindered operational planning and subverted parliamentary oversight.

The Government recognises that improvements in expenditure management and control are crucial to the achievement of its developmental and poverty reduction goals. MFEP introduced a 'Ten Point Plan' in 2000 which included a number of procedural changes intended to strengthen expenditure controls and has set ambitious targets for the reduction of the budget deficit over the medium-term. However, it is clear that improvements in public fundamental changes in the public sector and expenditure management systems are needed if these targets are to be achieved and the share of resources allocated to poverty reduction priorities increased. Five priorities are identified:

1. Rationalising and realigning central government

- Malawi's public sector is top-heavy. Central government institutions absorb a substantial part of the Government's limited financial and human resources, service delivery orientation is weak and decision-making excessively centralised. Attempts were made to rationalise central government institutions in the mid-to late-1990s, through a comprehensive series of functional reviews. These failed to identify significant changes in institutional mandates, largely because the technicians undertaking to reviews had no basis for radically reducing the public sector's role in the absence of clear political orientation regarding the role of the State and expenditure limits indicating future resource availability. The launch of the decentralisation programme, with elections for District Councils in November 2000, will force government to undertake more fundamental reviews. Over the medium term, responsibility for service delivery will be shifted to local authorities, with central ministries assuming policy, regulatory and support functions. This should lead to a shift in resources from central to local government and provoke significant down-sizing at the Ministerial level. Although Ministries have recently begun to prepare decentralisation strategies, the real test of the Government's commitment to the decentralisation process will arise when resource allocations for central government institutions have to be cut in order to finance the transfer of functional responsibilities to local authorities.

2. Aligning resources with policy priorities

- The Medium Term Expenditure Framework was the centrepiece of public expenditure management reforms introduced from 1995. It was supposed to provide a means of aligning aggregate spending with sustainable levels of financing and provide a predictable resource framework at the sectoral level. The method adopted, however, relied on a bottom-up expenditure planning process, rather than top-down expenditure limits, using a complicated Activity Based Budgeting system that failed to capture key components of spending, notably personnel and development expenditure, and was incompatible with budget categories. As a result, the MTEF was never integrated into the budget process and did not provide a comprehensive framework for expenditure programming at a policy level. Moreover, in the absence of institutional performance indicators and targets, the reformed budgeting systems provided no guidance for core institutions when contesting agencies budget and MTEF proposals. Revitalisation of the MTEF process is essential if the Government is to succeed in reallocating resouces from central to local government and towards poverty reduction priorities. An MTEF Action Plan has been drawn up but has yet to be approved.

Three elements are critical for the future success of the MTEF:

- Improvements in the presentation of budget information to Cabinet and Parliament. The recent introduction of a pilot 'output based budget' marks an important step in this direction, since this could link expenditure allocations to outputs and service delivery performance, thereby providing a stronger basis for expenditure analysis, budget contestation and decision-making. However, a considerable amount of work is still required in the formulation and negotiation of key performance indicators and targets at the institutional level and the restructuring of expenditures in terms of meaningful programmes.
- Application of top-down, medium-term expenditure limits. Multi-year expenditure limits communicate expenditure priorities and – where adhered to – improve the predictability of resource flows. This facilitates changes in the structure of expenditure, such as the shift in resources from central to local government and towards poverty reduction priorities. The process of setting top-down expenditure limits engages political leadership in the resource allocation decision-making at an early stage, before detailed budgets are prepared, and can provide a basis for broader consultations on priorities. However, if top-down expenditure limits to provide a meaningful basis for planning, they must integrate both internal and external financing and all expenditure components.
- Improvements in expenditure analysis. Expenditure policy should be informed by an understanding of the benefits of and trade-offs between alternative applications of scarce resources. This requires analysis at two levels. Firstly, analysis is needed at a policy level, focusing on the relationship between expenditure and the delivery of outputs and outcomes, thereby contributing to decision-making on expenditure allocations at the inter-sectoral and sectoral level. The Public Expenditure Review exercise, undertaken in 2000, could be developed to fulfil this function routinely. Secondly, analysis is required at an operational level, through the formulation of budget contestation criteria, which can be applied by technicians in the appraisal of agencies' MTEF and budget proposals.

This requires the formulation of key performance indicators at an agency level, which can be used to develop measures of efficiency and cost-effectiveness;

3. Improving compliance.

- Malawi's experience demonstrates that improvements in resource programming are often undermined by weak budgetary compliance. Compliance can be improved by reducing the extent of extra-budgetary expenditures and strenghtening controls on agency expenditures. The Government has indicated its intention to limit extra-budgetary expenditures to emergencies. However, given Malawi's track record and the relative weakness of the MFEP, extra-budgetary expenditures are unlikely to be controlled effectively without procedural changes. The most effective of these would be to enforce the legislative requirement for parliamentary approval of Supplementary Budgets where extra-budgetary expenditures exceed appropriations. Proposals for additional spending would then have to be justified and batched, allowing an assessment of trade-offs between alternative applications of additional resources. Recent changes in the funds' release mechanism should help curtail excess expenditures. However, these measures should be complemented by tighter commitment controls. Close monitoring of agency expenditures is also required. The proposed computerised IFMIS, scheduled for roll-out through central government in budget year 2001/02, should offer both these features. Enforcement of expenditure limits will require political commitment, both during budget preparation, when budget proposals should comply with centrally mandated limits, and during execution, when officials should be sanctioned and surcharged for excess expenditures.

4. Linking expenditure and poverty planning.

- Poverty analysis should inform the expenditure planning process. There are three critical intervention points. Firstly, when expenditure limits are set. This should occur at the very beginning of the planning process, so that proposals are resource constrained rather than needs based. In the current PRSP exercise, the PRSP thematic groups were given expenditure limits at a late stage in the formulation of their programmes. Furthermore, these limits were only indicative, and so allowed planners to present excess proposals for negotiation. While it is true that the formulation of expenditure limits must be iterative, allowing decision-makers to assess the trade-offs between alternative programmes, decisions should be taken before detailed planning starts. Secondly, through the formulation of poverty-related contestation criteria, so that agencies' proposals can be assessed in terms of their contribution to poverty reduction goals. Again, contestation critria should be informed by an analysis of the relationship between agency outputs and poverty indicators. And lastly, through the monitoring and evaluation of expenditure outturns and their relation to poverty outcomes, through routine in-year reporting on budget execution and the Public Expenditure Review exercise.
- Given the considerable variance in expenditure outturns in Malawi, there is a strong case for ringfencing priority poverty expenditures, as proposed by the PRSP Technical Committtee. There are risks to this approach, particularly as regards infelxibility where implementation rates are slow and increased compression on non-priority expenditures where revenue outturns are lower than anticipated. Furthermore, the designation of priority poverty expenditures will require changes in the presentation of budget documentation, quarterly expenditure reports and final accounts in order to facilitate the tracking of poverty expenditures. However these risks and challenges are more than outweighed by the benefits gained in terms of improved transparency and predictability of financing in priority areas.

5. Strengthening oversight and consultation.

- The legislature's scrutiny and approval of the executive's budget proposals and accounts provides an important safeguard of the public interest. In order for this scrutiny to be effective, expenditure proposals should be submitted at an early stage of the budgeting process so that the legislature's recommendations can be take taken into account during MTEF and budget formulation. This could best be achieved by presenting a Budget White Paper, prior to the setting of budget limits, based on the MTEF. This would indicate anticipated fiscal aggregates and allocations to sector level, with breakdowns by major expenditure component (personnel, goods and services, and capital spending) and for each of the priority poverty expenditures. Ideally, it would also link sectoral allocations to indicative targets for sectoral key peformance indicators. Final budget proposals would then be verified against the MTEF framework agreed at the start of the budget process. Effective oversight also requires the Government to submit proposals for alterations in appropriations to the legislature, through routine Supplementary Budgets. Timely quarterly expenditure reports should be presented if the legislature is to be able to track performance and verify compliance. Effective oversight is expensive; additional funding is needed if the National Assembly is to hold Budget and Finance Committee meetings throughout the year.
- Considerable progress has been made in opening-up the budget process through pre-budget consultations. Introduction of a Budget White Paper would support these consultations, by providing a concrete basis for discussion.

All of the measures identified above are feasible within the existing institutional and legislative framework. However, implementation requires a strong political commitment to improved compliance and greater transparency. Experience has shown that the improvements in compliance

are likely to be most difficult to achieve, largely because spending agencies have been able to exert political influence in order to gain access to extra-budgetary resources and the Government has proved unwilling to sanction agencies and senior personnel for excess expenditures. Compliance is more likely where the Ministry of Finance has sufficient authority to enforce hard expenditure limits on spending agencies and the legislature can enforce limits on Government. This would require a significant change in the balance of power in Malawi.

Table 4: Central Government Fiscal Operations, % GDP
(Estimates and budget from 1999/00)

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02
Total Revenue and Grants	22.8	22.6	22.4	20.0	27.0	25.1	20.9	18.3	22.1	23.5	30.8	30.1
Revenue	20.6	19.2	19.2	16.9	16.1	17.4	16.3	14.7	16.1	15.9	18.7	18.4
Grants	2.2	3.4	3.2	3.1	10.9	7.8	4.6	3.6	6.0	7.6	12.1	11.7
Total Expenditure	27.1	26.1	29.2	35.2	42.0	30.8	23.6	22.9	24.3	25.2	32.8	34.4
Recurrent	20.9	19.5	22.7	24.1	34.3	24.4	18.9	19.8	16.4	15.2	22.6	24.1
Development	6.1	6.6	6.5	11.1	7.7	6.4	4.7	3.1	7.9	10.1	10.3	10.3
Drought Related	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deficit Excluding Grants	-6.5	-6.8	-10.0	-18.3	-25.9	-13.4	-7.3	-8.2	-8.2	-9.3	-14.1	-16.0
Deficit Including Grants	-4.3	-3.5	-6.8	-15.2	-15.0	-5.7	-2.6	-4.6	-2.2	-1.8	-2.0	-4.3
Financing	4.8	3.5	6.8	15.2	15.0	5.7	2.6	4.6	2.2	-1.8	2.0	4.3
Net Foreign Borrowing	5.2	3.3	5.5	6.4	7.5	2.0	4.8	1.9	7.9	3.3	3.3	5.7
Borrowing	8.0	5.2	7.2	8.5	10.1	5.3	6.4	3.5	10.1	5.9	7.4	9.0
Repayment	-2.7	-1.9	-1.7	-2.1	-2.6	-3.3	-1.6	-1.6	-2.3	-2.6	-4.1	-3.3
Net Domestic Borrowing	-0.4	0.2	1.2	8.8	7.5	3.7	-2.2	2.7	-5.7	-5.0	-1.3	-1.4

Source: Economic Reports, Various Years

Note: Financing for 199/91 in original sources are not consistent.

Table 5: Central Government Revenues, % GDP
(Estimates and budget from 1999/00)

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02
Gross Tax Revenue	17.5	16.6	16.0	14.2	14.6	15.6	15.7	14.1	15.4	14.6	17.4	17.2
Incomes and Profits	7.3	6.7	6.4	5.7	5.2	5.5	6.6	6.0	6.8	6.7	7.8	7.5
Goods and Services	7.0	6.5	6.0	5.7	6.0	5.7	5.3	4.7	6.0	5.9	7.4	7.0
International Trade	3.2	3.4	3.5	2.7	3.5	4.4	3.7	3.4	2.6	2.0	2.3	2.6
Less Refunds	0.0	0.0	0.0	0.0	0.0	-0.5	-0.5	-0.4	-0.4	-0.3	-0.3	-0.4
Non-Tax Revenue	3.1	2.6	3.2	2.7	1.4	2.3	1.2	0.9	1.1	1.6	1.7	1.6
Total	20.6	19.2	19.2	16.9	16.1	17.4	16.3	14.7	16.1	15.9	18.7	18.8

Source: NEC, Economic Reports, Varios Issues.

Table 6: Structure of Expenditures by Economic Category, %

(Estimates and budget from 1999/00)

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02
Gross Consumption	67.3	63.4	68.6	73.3	75.3	57.3	56.6	55.9	50.4	61.2	59.4	60.4
Wages and Salaries	22.4	21.2	25.4	29.3	21.4	26.7	25.3	31.7	24.8	33.3	31.5	24.1
Other Goods and Services	44.8	42.2	43.2	44.0	54.0	30.6	31.3	24.2	25.6	27.9	27.9	36.2
Interest on Debt	16.8	20.1	15.5	11.3	15.1	26.5	27.0	18.2	30.9	23.3	22.5	20.4
Pensions and Gratuities	3.3	2.6	3.4	4.1	2.6	3.9	5.3	5.0	5.9	10.9	5.2	4.7
Grants and Subsidies	8.6	9.7	9.4	10.2	5.0	10.4	7.0	12.2	6.4	1.0	11.3	6.4
Gross Fixed Capital	3.6	3.5	2.6	0.8	1.8	1.5	2.7	2.1	1.0	3.5	1.5	2.3
Loans and Capital Transfers	0.5	0.7	0.5	0.4	0.2	0.4	1.3	6.6	5.3	-	0.2	5.9
Total Recurrent	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Gross Consumption	27.6	27.6	43.7	30.6	30.0	38.2	28.1	32.1	37.7	40.9	25.1	33.0
Wages and Salaries	8.2	8.2	8.9	9.0	5.9	17.8	10.6	7.6	11.7	2.5	1.4	2.4
Other Goods and Services	19.4	19.4	34.8	21.6	24.0	20.4	17.5	24.6	26.0	38.5	23.6	30.5
Interest on Debt	-	-	-	-	-	-	-	-	-	-	-	-
Pensions and Gratuities	-	-	-	-	-	-	-	-	-	-	-	-
Grants and Subsidies	1.9	1.9	1.6	0.8	- 0.0	0.8	0.2	0.0	1.5	12.6	12.5	13.8
Gross Fixed Capital	66.3	66.3	54.4	68.1	70.0	60.9	71.7	67.7	60.8	46.5	62.5	53.3
Loans and Capital Transfers	4.2	4.2	0.3	0.4	0.1	0.1	0.0	0.1	0.0	-	-	-
Total Investment	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Gross Consumption	58.3	54.4	63.1	59.8	67.0	53.3	50.9	52.6	46.3	53.1	48.7	52.2
Wages and Salaries	19.2	17.9	21.7	22.9	18.6	24.9	22.4	28.4	20.6	21.0	22.1	17.7
Other Goods and Services	39.0	36.4	41.3	36.9	48.5	28.5	28.5	24.2	25.7	32.1	26.6	34.5
Interest on Debt	13.0	15.0	12.1	7.7	12.3	21.0	21.7	15.7	20.9	14.0	15.5	14.3
Pensions and Gratuities	2.5	2.0	2.6	2.8	2.1	3.1	4.3	4.3	4.0	6.6	3.6	3.3
Grants and Subsidies	7.1	7.7	7.7	7.2	4.1	8.4	5.7	10.5	4.8	5.6	11.6	8.6
Gross Fixed Capital	17.9	19.4	14.1	22.1	14.2	13.9	16.4	11.1	20.4	20.6	20.5	17.5
Loans and Capital Transfers	1.3	1.6	0.5	0.4	0.2	0.3	1.1	5.7	3.6	-	0.1	4.1
Total Investment	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: NPC Economic Reports, Various Issues.

Table 7: Structure of Expenditures by Function, %
(Estimates and budget from 1999/00)

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02
General Services	37.7	28.9	35.6	37.3	27.6	23.3	25.1	27.4	32.1	27.1	50.0	32.1
Social Services	22.5	18.0	20.6	20.0	35.8	37.1	33.7	40.0	30.5	41.4	27.6	38.6
Education	12.0	8.7	11.4	11.1	10.4	16.0	18.2	18.3	15.1	18.3	12.2	13.4
Health	7.3	6.8	6.5	6.7	11.5	9.7	8.8	5.1	6.9	10.2	8.7	10.5
Social Security & Welfare	-	-	-	-	12.2	9.6	5.1	11.2	6.9	11.3	5.6	13.6
Others	3.3	2.5	2.7	2.1	1.7	1.8	1.7	5.4	1.5	1.6	1.0	1.2
Economic Services	15.2	25.6	24.2	26.1	10.6	13.3	7.4	8.2	6.2	8.2	5.7	8.1
Agriculture	8.5	13.7	12.2	10.0	5.9	8.8	4.9	4.7	4.7	5.7	3.4	5.5
Unallocable	24.6	27.5	19.7	16.6	26.0	26.2	33.8	24.4	31.2	23.3	16.7	21.2
Total Recurrent	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
General Services	7.4	8.4	39.0	51.6	28.1	15.9	39.8	14.5	10.1	21.9	20.5	23.5
Social Services	28.6	28.6	43.6	18.9	50.9	54.2	28.7	41.4	58.4	37.0	30.3	44.8
Education	12.9	12.9	17.6	6.6	28.0	22.6	8.4	19.4	14.5	9.1	11.9	12.8
Health	8.3	8.3	16.3	4.1	0.4	16.2	3.6	7.5	17.9	6.0	1.1	14.2
Social Security & Welfare	-	-	-	-	-	0.1	0.7	0.3	1.7	1.1	-	-
Others	7.4	7.4	9.7	8.2	22.5	15.3	15.9	14.3	24.4	20.9	17.2	17.8
Economic Services	64.0	63.0	17.5	29.5	15.1	23.9	16.2	40.8	27.3	41.0	49.3	31.7
Agriculture	20.0	20.0	14.0	9.1	14.1	10.4	10.3	13.3	11.4	13.6	6.3	10.2
Unallocable	-	-	-	-	6.0	6.0	15.3	3.2	4.1	-	-	-
Total Investment	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
General Services	30.8	23.7	36.3	41.8	27.7	21.8	28.0	25.6	25.0	25.0	40.8	29.5
Social Services	23.9	20.7	25.7	19.6	38.6	40.7	32.7	40.2	39.5	39.7	28.4	40.4
Education	12.2	9.8	12.8	9.7	13.7	17.4	16.2	18.5	14.9	14.6	12.1	13.2
Health	7.5	7.2	8.7	5.9	9.5	11.1	7.8	5.5	10.4	8.5	6.3	11.6
Social Security & Welfare	-	-	-	-	9.9	7.6	4.2	9.7	5.2	7.2	3.9	9.5
Others	4.2	3.7	4.2	4.0	5.5	4.6	4.5	6.6	8.9	9.3	6.1	6.2
Economic Services	26.3	35.1	22.7	27.2	11.4	15.5	9.1	12.7	13.1	21.3	19.3	15.1
Agriculture	11.1	15.3	12.6	9.7	7.4	9.2	6.0	5.9	6.9	8.9	4.3	6.9
Unallocable	19.0	20.6	15.3	11.4	22.3	22.0	30.2	21.5	22.4	14.0	11.5	14.9
Total Expenditure	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: NPC Economic Reports, Various Issues.

Table 8: Structure of Agency Expenditures by Function, %
(Estimates and budget from 1999/00)

	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02
Education	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Administration	14.4	13.8	11.6	15.0	8.9	6.7	7.6	14.3	10.1	7.7	6.3
Primary	63.9	70.0	69.2	68.2	76.5	77.2	77.3	71.1	75.8	74.5	66.2
Secondary	15.3	12.1	14.2	11.7	10.3	11.6	10.9	11.9	12.8	15.1	19.5
Teacher Training	6.5	4.2	5.0	5.0	4.2	4.5	4.3	2.7	1.4	2.7	8.1
Health	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Administration	14.1	12.2	14.3	14.7	6.5	10.9	9.4	13.3	5.6	4.1	8.2
Institutions	81.5	83.5	82.1	82.5	91.0	82.6	88.0	78.0			
Primary Curative									21.6	19.2	31.7
Other Curative									41.3	39.4	56.7
Other	4.4	4.3	3.6	2.8	2.5	6.5	2.6	8.6	31.5	37.3	3.3
Agriculture	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Administration	58.5	62.8	58.1	59.0	64.2	70.6	65.6	66.3	63.7	44.0	43.7
Agricultural Services/	5.8	4.5	4.4	4.3	2.9	3.2	2.7	8.0	2.7	19.2	17.8
Veterinary Services	16.6	11.1	11.0	13.0	11.1	10.6	10.7	8.9	10.4	10.8	11.5
Other	19.2	21.6	26.5	23.7	21.8	15.6	21.0	16.8	23.2	26.0	26.9

Source: Budget Actuals, Various Issues. MoFP Budget databases.

Note: Education spending to 1997/98 includes only functions attributed to Ministry of Education from 1998/99, excluding technical and tertiary education.

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	Mr Mathews Makalande, Assistant Budget Director
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