

# Executive Summary

## A. INTRODUCTION

1. Malawi is one of the poorest countries in the world and little appreciable progress has been made in improving social indicators during the last 30 years. The main objective of the Public Expenditure Review (PER) is to assess and improve the quality and content of public expenditure in Malawi, leading to an improvement in social indicators through three main channels. Firstly, by helping to maintain fiscal stability and therefore facilitating growth and poverty reduction. Secondly, by raising real returns to public expenditures and thirdly, by ensuring that expenditures are directed to goods and services that are mostly used by the poor.

2. This PER was a joint exercise conducted by the Government of Malawi and the World Bank. On a macro level, the PER analyses overall trends in expenditure, the institutional framework for expenditure management (particularly the budget process) and finally, the development budget. On a sectoral level, this PER analyses the four key sectors of education, health, agriculture and roads. For each of these sectors, the PER analyses past trends in intra-sectoral expenditure and then recommends future reallocations on the basis of the past trends, benefit incidence analysis and prioritisation through a reassessment of the role and resources of Government.

3. The PER is designed to complement existing and ongoing work on improving the quality of public expenditure. In particular, the PER is a timely input into the Poverty Reduction Strategy Paper (PRSP) formulation process and is intended to strengthen the Medium Term Expenditure Framework (MTEF) process.

## B. MACROECONOMIC OVERVIEW

4. During the last two decades of structural adjustment, Malawi's economic performance has been unsatisfactory. Although there have been periods of stability and growth, these have been more than matched by periods of macroeconomic instability and low or even negative growth. This is due to a number of factors, including external shocks, inconsistent implementation of reforms, and fiscal indiscipline and instability. In particular, stabilisation and growth were undermined in the early 1990s by a combination of severe droughts in 1992 and 1994 and expenditure slippages around the 1994 General Elections.

5. Difficulties of expenditure management and prioritisation are the main reasons for fiscal indiscipline and instability, which have had large economic costs. High fiscal deficits have led to large amounts of domestic borrowing by government, crowding out private sector investment and putting pressure on inflation, interest rates and exchange rates. In addition, this borrowing has increased interest payments, reducing the amount of resources available to fund priority government activities.

6. The introduction of the cash budget has helped reduce deficits but has come into conflict with the strategic prioritisation goals of the MTEF. As a result of the dependence on cash flows, expenditure on goods and services (which is the most discretionary form of expenditure in the recurrent budget) has been volatile and is dependent on foreign loan funding. Making expenditures more stable will require more smoothing of foreign financing flows and reform of the cash budget system.

7. Trends in expenditure by functional classification show that in real terms, expenditures on interest payments and the development budget have increased, while expenditure on other recurrent transaction and wages and salaries have fallen by as much as 50 percent. However, Government functions have not been reduced in line with the budgetary squeeze – this has led to under-funded activities with resources being spread too thinly across too many activities. As a result, there is need to re-examine the role of government and implement genuine prioritisation. In addition, the real decline in civil service salaries has undermined morale and performance in the civil service. There is therefore need to reform the civil service salary structure.

8. Trends in expenditure by economic classification reflect the current government's focus on the social sectors, particularly education and health. Actual total expenditure on the social sectors rose from 6.16 percent of GDP in 1993/4 to 9.24 percent in 1998/9. Over the same period, expenditure on general administration fell from 9 percent to 5.48 percent and expenditure on the economic sectors (agriculture, infrastructure, tourism, industry and commerce etc.) fell from 16.02 percent to 2.95 percent. Although government's policy is largely to encourage private sector participation in economic sectors, there may be a case for ensuring adequate funding for some these sectors (infrastructure, agriculture) so as to create an environment conducive to private sector growth and poverty reduction. Given the relatively small decline in general administration and unallocable services, funding for economic sectors could come from reduction in these areas. However, this may depend critically on faster civil service reform and prudent fiscal management leading to reduced debt service costs.

9. Intra-sectoral prioritisation also requires significant attention. Expenditure on administration and other non-priority activities within key sectors such as education remains high. It is therefore recommended that any increase in resources allocated to the social sectors be targeted towards the actual high priority activities. In addition, there has been persistent expenditure on non-budgeted activities on the recurrent budget, resulting in under-funding of priority activities and overall over-expenditure expenditure. This is due to a number of problems, including poor budget estimates, political directives, arrears, the unstable exchange rate, and failure to deliver donor commitments.

10. Revenue performance has been relatively stable despite changes in the revenue structure. Some improvements have been made in tax administration and in broadening the tax base. However, tax buoyancy (the change in tax revenue resulting from a 1 percent change in GDP) has averaged less than 1 percent, thereby demonstrating the need to further improve the structure of the tax system. Non-tax revenue performance has continued to be poor as a result of poor incentives for collection.

11. Government's medium term macroeconomic objectives are (i) to increase real GDP growth from an average of 3 percent in the 1990s to more than 6 percent in the 2000s; (ii) to reduce the average annual inflation rate from the double digits in the 1990s to single digits in the 2000s; and (iii) to continue strengthening the Balance of Payments position. This will require steadfast control of Government expenditure. In addition, government recognises the need to improve the allocation and quality of public expenditure through the MTEF process.

### **C. INSTITUTIONAL ANALYSIS**

12. The budget process is the central tool for the management of public expenditure. It consists of a number of stages, namely the setting of priorities; the preparation of the Budget;

the implementation of the budget; monitoring of expenditure; evaluation and audit; and policy review. The stages are interdependent and improvements in public expenditure management depend on improvements at all stages. The Medium Term Expenditure Framework (MTEF) is a particular way of conducting the budget process, focusing on prioritisation, linking outputs to inputs, and medium-term strategic expenditure planning. The central problem of the budget/MTEF process in Malawi is that the budget process is still dominated by the preparation of the Budget, which remains an incremental inventory of inputs prepared by accountants in line ministries. The MTEF is seen as a separate system of unimplemented prioritisation exercises prepared for the Ministry of Finance by the planning sections of line ministries.

**(i) Overall issues**

13. A central reason behind many of the problems of the budget process is a lack of co-ordination at all levels. Firstly, at a macro level, the roles of the Ministry of Finance and Economic Planning and the National Economic Council have yet to be fully clarified. Secondly, there are problems within the Ministry of Finance and Economic Planning, particularly in defining the roles of the Economic Affairs, Budget and Debt and Aid Management Divisions. Thirdly, there are co-ordination problems between the Ministry of Finance and Economic Planning and the line ministries, in particular a lack of communication about new initiatives and sectoral expenditure ceilings. In this respect, the recruitment and training of desk officers in the Budget Division of the Ministry of Finance and Economic Planning must be a priority. Overall, in order to implement an MTEF based budget, effective leadership from the Ministry of Finance and Economic Planning is needed.

14. Co-ordination problems between planning and finance staff within the line ministries are a key reason for the lack of implementation of prioritisation activities. Strategies to overcome this problem include the strengthening of planning sections and the resuscitation of Budget Co-ordination Committees. Finally, co-ordination problems between government and donors can be resolved through strong government leadership and the use of co-ordinated Sector Investment Programmes (SIPs) and Sector Wide Approaches (SWAs). In addition, a central co-ordinating body for policy review and reform initiatives should be created to ensure proper dissemination and that duplication of effort is kept to a minimum.

15. A second overall reason for the failures of the budget process is the lack of capacity (especially human). This is largely a result of incentive structures in the civil service, a high attrition rate (partly due to the HIV/AIDS epidemic) and low supply of qualified applicants. This makes any solution to the capacity problem complex and long term.

**(ii) Problems at specific stages of the budget process**

**Priority setting – The MTEF**

16. The MTEF was introduced in 1995 in order to address a number of problems with the budget process, most notably the failure to link policy making and planning to the recurrent budget. Although the MTEF has had some success, particularly in improving the definition of goals and objectives across government, it has so far failed to live up to expectations. Specifically, the implementation of intra-sectoral prioritisation has been limited, largely as a result of the failure to integrate the MTEF fully into the budget process. This is partly the result of a lack of understanding of the MTEF and the common perception that it is a World

Bank and Budget Division-owned process. Thus building understanding and ownership of the MTEF process, particularly among senior managers, is critical.

17. Two technical problems associated with the priority setting stage of the budget process have been the lack of adequate capacity in government to produce either realistic costings of priority exercises or projections of resource flows. These are crucial in bridging the gap between policy making and implementation.

### **Budget Preparation**

18. Budget preparation within individual ministries is supposed to be done through Activity Based Budgeting (ABB). However, in most ministries, individual ABBs have not been consolidated at Ministry level, since there is a perception that it is line item budgets that matter in the determination of the final national Budget. For ABB to become a reality, the Ministry of Finance and Economic Planning must put in place adequate incentives and support structures.

19. Consolidation of Ministry budgets is time consuming and often increases the number of errors in the final Budget document. This could be reduced by ensuring that ministry budgets are submitted in a common electronic format. Finally, the shortage of time towards the end of the budget process reduces the scope for detailed macroeconomic analysis of the final budget.

### **Budget Implementation**

20. The persistence of considerable off-budget expenditure is the key symptom of a failure to enforce the Budget. The cash budget system was introduced in 1996 to improve enforcement and thereby fiscal discipline. However, it has failed to create a shift in attitudes towards an understanding of the need to maintain hard budget constraints. In addition, the cash budget system comes into conflict with the MTEF process insofar as ministries' planned activities may be delayed or cancelled because of unpredictable cash flow. Improvements to the cash budget system have recently been made through the introduction of the Credit Ceiling Allocation Mechanism (CCAS) and related reforms in the "10 Point Plan".

21. Central to the creation of hard budget constraints is the clarification of responsibilities for expenditure and the enforcement of sanctions against those responsible for deviations from the budget. In particular, there is need for punitive measures to be introduced in the Finance Act for the controlling officers who continue to receive goods and services on credit leading to the accumulation of arrears. Improving sanctions will also involve increasing Parliamentary scrutiny of expenditures through the Public Accounts Committee and the Budget and Finance Committee.

### **Monitoring Expenditure**

22. Creating hard budget constraints also depends on effective monitoring of expenditure to ensure consistency between expenditure returns and the budget. Improving monitoring largely depends on improving the quality and timing of the expenditure returns. These issues are being addressed through the introduction of a new system of expenditure returns and of the Integrated Financial Management Information System (IFMIS). International experience demonstrates the need to proceed with caution in the introduction of IFMIS.

### **Evaluation, audit and policy review**

23. Proposed reforms to the National Audit Office are expected to improve the quality and timeliness of audits. Government should introduce an annual PER as part of an overall policy review mechanism.

## **The Way Forward**

24. Government has conducted an MTEF Review in order to produce a detailed and implementable improvement plan for the MTEF. This Review included stakeholders from across government. The Review and Action Plan focus on achieving seven essential characteristics, namely: political involvement and commitment, effective management and co-ordination of budget reforms; predictability in the funding of services; clear, consistent and affordable policies; transparency in the preparation and presentation of the budget; comprehensiveness of budget coverage; and accountability.

### **(iii) Other institutional reforms**

25. Decentralisation will fundamentally change the way in which government receives and spends its resources. Decentralisation may provide an opportunity to adopt new and more effective methods of public expenditure management. Careful attention must be paid to designing an institutional framework that supports an MTEF-style budget process.

26. The co-ordinated introduction of Sector Investment Programmes (SIPs) and Sector Wide Approaches (SWAs) is important for improving expenditure planning at a sectoral level and for improving donor co-ordination. The central objective of a SWA is to move away from a piecemeal project approach to sector interventions and towards establishing a partnership led by government and including donor agencies and other sector stakeholders covering all interventions in the sector. This is facilitated by SIPs, which define Government policies, priorities and intended expenditure in each sector. The introduction of SIPs and SWAs is a long term process with variable speeds between sectors and stakeholders.

## **D. REVIEW OF THE DEVELOPMENT BUDGET**

27. The development budget accounts for an increasing share of total government expenditure, reaching 25.3 percent in 1998/99. The majority (66 percent in 1999/2000) of development budget expenditure is spent on the key sectors of education, health, agriculture, water and roads. Wages and salaries (13 percent) and operations and maintenance (23 percent) together account for 36 percent of development expenditure whilst building accounts for 27 percent (averages 1995/6-1998/9).

28. Donor resources make up over 80 percent of development expenditures. Of this, grants account for around 28 percent (1997/8-1998/9 average) and loans 72 percent. This means that around 58 percent of development expenditure is financed through loans, which raises concerns about the sustainability of development projects and future budgetary pressures through interest payments. Government should therefore find ways of increasing the share of domestic and foreign grant resources funding the development budget.

29. In general, actual development expenditure has been less than budgeted development expenditure. This is due to capacity problems associated with both Government and donors. On the Government side, frequent delays or non-availability of necessary counterpart funding has led to the delay, scaling down or cancellation of many donor funded development projects. The lack of or delays in counterpart funding are largely due to lower than expected revenues or higher than expected recurrent expenditures that take priority over development expenditures. The problem is particularly acute for projects where reimbursement donor financing occurs since the reimbursement mechanism requires Government to make an up-front payment that will be reimbursed after verification. Problems are also caused by inaccurately costed and incomplete annual work programmes (AWPs). Improving

expenditure prioritisation and implementation is the key solution to these problems, and moving away from reimbursement mechanisms will minimise disruptions.

30. On the donor side, delays and cancellation of projects are strongly associated with multiple and varied conditions for the release of donor funds. In addition, disbursement patterns are generally lumpy and front-loaded, and implementation and accounting procedures used vary between donors. Government should negotiate for fewer conditionalities and ensure that key stakeholders are fully involved in grant and loan negotiations. There should be capacity building in the Debt and Aid Management Division of the Ministry of Finance to enable it to track aid inflows and ensure conditionalities are met. Donors should ensure that projects are consistent with overall sector priorities and consider making longer term commitments with less lumpy disbursement – in summary, moving towards a Sector-Wide Approach (SWAp).

31. The existing development budget fails to cover a large number of projects implemented by Government and non-Governmental organisations (NGOs). In order to gain control over public expenditure, it is essential that at least Government managed projects be included in the development budget.

32. Prioritisation of development expenditure in line with national objectives (particularly poverty reduction) is essential to realising those objectives. Significant inter-sectoral prioritisation has been achieved, as demonstrated by the high proportions of development resources going to education, health and agriculture projects. A review of projects in these sectors demonstrates that intra-sectoral prioritisation must be improved. This prioritisation must be fully implemented so that low-priority projects are eliminated and high-priority projects are fully funded.

33. In the past, the recurrent cost implications of development budget projects have not been taken into account. Even when the Public Sector Investment Programme (PSIP) was in place, Government accepted donor designed and funded projects without considering their consistency with sectoral priorities and their recurrent cost implications. As a result, the recurrent costs of capital investments were underestimated and many donor projects were found to be unsustainable. As part of the PER analysis, an estimate of the r-coefficient (ratio of annual net recurrent expenditure requirements of completed investment expenditure to the value of the total investment expenditure) was made for different sectors on an aggregate project level. The results confirm the need of significant recurrent cost implications, although it is recognised that more reliable results would require further disaggregation of the data.

34. The integration of the recurrent and development budgets is desirable for several reasons. Firstly, although the development budget is supposed to cover investment expenditure, it contains a considerable portion of expenditures that are operational in nature. Conversely, the recurrent budget contains significant capital formation. As a result, analysis and prioritisation are confused. Secondly, the integration of the two budgets would increase awareness of the recurrent implications of development expenditure, as discussed above. Thirdly, the separation of the two budgets is a legacy of the old separation of planning and finance functions in Government. Government is now moving towards the integration of these two functions, necessitating an integration of the two budgets. However, despite being one of the stated objectives of the MTEF, there has so far been little progress in integrating the two budgets. Recent moves towards developing Sector Wide Approaches (SWAs) in the key sectors may facilitate moves towards integration by moving donor funding away from individual development projects towards general budget support.

## **E. EDUCATION SECTOR REVIEW**

### **(i) Findings from performance and expenditure review 1993 to 2000**

35. Primary school enrolment has risen by over 50 percent over the period, largely due to the abolition of school fees in 1994. However, there are very high rates of dropout and repetition, especially in low standards and for girls. The current survival rate to standard 8 is about 30 percent. The majority of students who sit the primary school leaving certificate pass, but the transition rate to secondary education is only about 65 percent.

36. Secondary school enrolment has trebled over the period, with the largest absolute increase in community day secondary school students. These currently make up about 55 percent of enrolment. Nevertheless, access to secondary education is still limited: the gross enrolment ratio is less than 30 percent. There are a number of inequalities present in the system. Firstly, access is heavily skewed in favour of children from high-income families. Secondly, girls are under-represented and account for about 40 percent of enrolment. Finally, there is a huge disparity in the MSCE pass rate between conventional and community schools and the trend has worsened considerably over the period. In 1999, the CDSS pass rate was 4 percent.

37. Enrolment at university level has increased very little over the period and is below 4000 students. Female students occupy less than 30 percent of places and are particularly under-represented in science disciplines. Enrolment is almost completely skewed in favour of high-income families and no students from the lowest socio-economic group were found to be enrolled.

38. The government has made education a high priority, increasing its share of the national recurrent budget from 22 percent in 1993/1994 to 28 percent by 1999/2000. Within this allocation, there has been a clear shift in favour of primary education. In terms of development expenditure, up until 1998/1999 government loans mainly financed primary construction. However, in the last two years there has been a move into construction of day secondary schools. Bi-lateral donor grants are substantial in the education sector, more than matching the loan funds, and are focused on primary construction.

39. Primary students receive a vastly lower public resource allocation, on a per student basis, than their counterparts at higher levels. Over the period, the question has worsened in relation to the university student who currently receives over 200 times the amount of a primary student. These ratios are considerably higher than regional norms.

40. Between 1990 and 1998, the distribution of both public and primary secondary expenditures has become more pro-poor. Nevertheless, at secondary level the distribution is still extremely inequitable: over half of secondary public expenditure accrues to the richest 40 percent of households, and boys benefit more than girls.

41. The definition of "Free Primary Education" varies among different communities. Although no fees are charged, some parents contribute directly to general purpose funds, provide labour in kind for construction projects, and supplement government provision of learning materials. At secondary and university level, fee levels are extremely low in real terms and collection rates are less than 50 percent. Approximately 5 percent of public secondary costs are recovered from fees and at the University of Malawi the rate is 1 percent.

## **(ii) Value for money analysis**

42. At primary level, salary expenditure is severely crowding out other quality inputs, which accounts for less than 20 percent of total expenditure. The amount spent on teaching and learning materials is less than 50 percent of the recommended US\$5 per pupil. However, there appears to be little scope for reducing the salary bill: pupil teacher ratios are high and salary levels are low in real terms. In short, more resources need to be allocated to the primary sub-sector to fund quality inputs.

43. The distribution of primary teachers across divisions, between urban and rural areas, and between standards, is extremely inefficient. Female teachers are concentrated in urban areas, which is a particular worry for the attainment of rural girls. In terms of effectiveness, roughly half of the primary system's resources are being spent on dropouts and repeaters. The average duration of study for a dropout is much less than 4 years through to be necessary to achieve functional literacy.

44. In conventional secondary schools, expenditures on boarding and 'other' non-salary expenditure are crowding out quality inputs. Like the primary system, teachers are not deployed efficiently across divisions, and pupil teacher ratios are much lower in conventional secondary schools than in CDSSs. Furthermore, nearly all the trained teachers are in conventional secondary schools. CDSSs receive minimal non-salary funding, although the recent introduction of a textbook fee means that all students now have access to textbooks.

45. Over the period, cost-effectiveness in the conventional secondary system has fallen dramatically. Whilst enrolment has nearly doubled, the number of graduates has remained almost static. In tertiary education, there are vast differences in student lecturer ratios, and public expenditure per student in the 6 primary teacher training colleges. There appears to be scope for redistributing resources between colleges to improve efficiency.

46. The University of Malawi spends over half its budget on boarding and administration. In 1999, these items alone amounted to US\$1500 per student. This is a marked contrast to the average of US\$200 spent on teaching and learning materials over the period. Given that over 60 percent of student places are in applied fields, such as science and medicine, this seems inadequate. Furthermore, student to staff ratios are grossly inefficient, due to the wide range of subjects offered and the small enrolment. In the extreme case, one college has a ratio of 1:1.

## **(iii) Key policy recommendations**

47. Realistic cost sharing schemes should be introduced at secondary and university level, to free up resources for quality improvements at primary level. The success of these measures will depend on the implementation of other policy reforms, which will improve the quality and efficiency of secondary and university education services. Parents/students should not be expected to pay for inefficiencies currently in the system. In short, investors will be reluctant to pay unless they see tangible benefits and get value for money.

48. Improving access at secondary and tertiary level should be an important objective. The introduction of local area recruitment would allow a phased process of de-boarding to begin at secondary level and an expansion of day schooling. Promoting a more judicious use of physical facilities, through double shifting at secondary level, and through weekend and holiday time use at the university, would enable greater access at a lower unit cost. Private

sector provision should be encouraged through a partnership arrangement, which would enable the government to ensure quality standards. Finally, to ensure that the poor are not disadvantaged, a targeted bursary scheme should be implemented at secondary level, and the student loan scheme re-vamped at university level.

49. There are several measures aimed at improving quality. Firstly, given that the current annual attrition rate is approximately 11 percent, a high volume programme of initial teacher training needs to continue in the medium term. At secondary level, a fast track method of training untrained teachers, who currently staff the CDSSs, is urgently needed. Secondly, adequate provision needs to be made in the recurrent budget for teaching and learning materials for primary schools and for school inspection and advisory visits. This should include support for the zonal in-service teacher education programme. Finally, maintaining the existing stock of furniture and building, as well as constructing new buildings to minimise the number of pupils being taught outside, should be a priority. In this light, the partnership between government and communities should be strengthened.

50. Recommended cost saving measures include raising pupil teacher ratios in conventional secondary schools and. Both double shifting physical facilities (but using the same teachers in both shifts), and ensuring that newly trained secondary teachers are able to teach at least two subjects could achieve this. At the university, the student to administrator/lecturer ratios need to be dramatically reduced. Finally, the exam system should be rationalised by reducing the number of subjects and papers offered.

51. Reducing the enormous primary dropout and repetition rates is a major priority in improving cost-effectiveness. Putting in place measures to improve the quality of education, and continuing to sensitise the community on the need for regular attendance, form the core of the recommendations. Other means of improving the efficiency of expenditures are to reduce the resource inequities across standards, regions and between different types of school.

52. Improvements in the government budget system are needed to ensure that the recommended resource shifts actually take place. This includes the development of a sector-wide expenditure and output monitoring process. Furthermore, secondary school fees should be retained at school level, and not remitted to the central treasury, in order to improve collection rates, accountability and effectiveness.

#### **(iv) Costing of Key Recommendations**

53. An enrolment transition model is used to cost the recommendations above, over a 15-year period 1997 to 2012. Costs are then matched with projected government, student and donor funds, and any gaps are quantified. The projections assume that government recurrent funds to the education sector increase in real terms over the period. However, there are dramatic shifts within the budget between programmes. The share to primary increases, whilst that to the university and to administration falls. This is a result of implementing the cost sharing measures and efficiency gains respectively. Donors are projected to provide support for recurrent inputs such as pedagogical inputs, primary teacher education and sector planning. These contributions mainly cover the period 1997 to 2007. An attempt is made to model realistic policy changes and so the recurrent funding gaps are not striking<sup>1</sup>. In terms of capital expenditure, there is a huge need for construction at both primary and secondary level, even

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<sup>1</sup> Secondary teacher education has not been explicitly costed and there is probably a substantial gap in funds required.

allowing for the efficiency gains resulting from double shifting. The funding gap at primary level is about US\$245 million, while at secondary level it is approximately US\$73 million.

## **F. HEALTH SECTOR REVIEW**

54. Health indicators in Malawi continue to be worrying, resulting in a reduction of life expectancy at birth to 44 years, and an increase in the dependency ratio from 0.92 in 1966 to 1.05 in 1995. International evidence demonstrates that this decline cannot be blamed entirely on the low and declining levels of per capita health expenditure (US\$7.82 in the mid-1990s, now lower). In addition, health indicators have continued to worsen despite recent improvements in the allocation of resources by level of care. The reasons for poor sectoral performance therefore lie in technical efficiency, the incentive structure of staff and the overall institutional environment of the health sector. This combination of factors gives rise to the more direct causes of the poor health indicators, such as the high population-per-physician statistics. In addition, problems outside the health delivery system, such as the HIV/AIDS epidemic; and poor water and sanitation; and low literacy levels, reduce the effectiveness of health interventions and therefore need to be addressed.

### **(v) Trends in public health expenditure**

55. Despite the increase in the share of health expenditure in total government expenditure (from 7.3 percent in 1991 to 11.6 percent in 1999), real per capita health expenditure has declined over the same period. Within this allocation, the proportion going to primary facilities (district and lower level facilities) has risen at the expense of central headquarters administration and central tertiary hospitals. Despite this, the number of primary facilities remains inadequate using standard facility/population ratios and a large number of existing facilities are in poor repair and under-staffed. In addition, bypassing of primary facilities in favour of less cost effective tertiary facilities is common. Poor patient management, particularly at tertiary level, further undermines the efficiency of expenditure.

56. Personal emoluments continue to account for the bulk of Ministry of Health and Population recurrent expenditure, averaging around 36 percent between 1992/1993 and 1997/1998. However, this proportion has begun to fall as a result of large-scale departures from the civil service due to resignation and death.

57. Per capita government drug expenditure rose from US\$0.60 in 1994/5 to US\$0.78 in 1997/8 and has subsequently increased further. However, this expenditure continues to be below regional and recommended levels of around US\$1.00-1.50. Also, despite the rise in per capita expenditure, drugs shortages have persisted, due to diversion to the private sector, inefficient distribution and excessive prescription. Expenditure on supervision and monitoring is inadequate, particularly given the impending decentralisation of health services.

58. Reflecting the Ministry of Health and Population's overall focus on infrastructure rather than health services, hospital expenditures focus on hospital and physical asset management rather than patient care. Of the patient care costs, expenditure on food for inpatient care dominates the cost of providing services, particularly in central hospitals.

59. Donor expenditure is focused on primary, preventative and promotive care. However, significant amounts are spent on subcontracts, technical assistance and training of Ministry of

Health and Population personnel (recognised as disguised salary support). In addition, there is evidence of limited capacity to absorb an increasing level of donor resources, resulting in slow implementation of donor-funded projects. This is due to excessive demand for limited Ministry of Health and Population capacity by both government and donors.

60. The development budget continues to be non-comprehensive as a number of donor expenditures do not get reported. Those donor expenditures that are reported remain within the development budget despite the fact that they have a significant proportion of recurrent expenditure. As a result of these factors, analysis of the development budget and its relationship with the recurrent budget is difficult.

**(vi) Critical analysis of future goals of the health sector**

61. The National Health Plan (NHP 1999-2004) focuses on introducing an Essential Healthcare Package (EHP), increasing capacity (particularly human), decentralisation, the introduction of cost recovery and the introduction of a sector wide approach (SWAp). However, at present the NHP lacks a clear implementation plan, and in particular has insufficient links to the budgeting process. It also appears that the NHP is overly ambitious in terms of the targets set and resources required. In addition, there are a number of flaws in the NHP related to the focus on facilities rather than programmes, the estimation of recurrent costs and the need for additional personnel. There is therefore need for a NHP Implementation Plan that corrects these flaws, sets more manageable and phased targets, and properly prioritises activities under the plan in order to produce a realistic financing plan.

62. As part of the PER, a simple simulation model was developed to demonstrate the impact of changes in key cost and treatment parameters affecting the health system. The results demonstrate that substantial increases in the overall coverage of the system could be achieved without increasing overall budgetary levels.

**(vii) Funding gap analysis**

63. Funding gaps are calculated on the basis of various international standards and of adjusted funding requirements for the NHP compared with estimates of resources available over the next five years. Whichever method is used, there is a substantial funding gap over the next five years. The central strategy for closing this gap is to introduce more cost sharing. The benefits of cost sharing come through resource mobilisation, increases in efficiency (elimination of unnecessary attendance, better demand and supply management of drugs, better referral) strengthened consumer sovereignty (leading to demand for better services), and institutional strengthening at lower levels (particularly relevant in the context of decentralisation). Support for cost sharing is demonstrated by the use of CHAM facilities. The introduction of cost sharing should be done in a phased manner according to a clearly defined national cost sharing policy.

**(viii) Improving health expenditure management**

64. Improving the effectiveness, equity and sustainability of health expenditures depends on changing from incremental budgeting and resultant thinly spread expenditure to a strategic approach to budgeting, focusing on prioritising health programmes. In particular, government needs to move away from its focus on health infrastructure, particularly district and central hospitals, towards broader approaches to dealing with health problems, especially at the primary care level. Government should focus interventions on the provision of services that

address the highest disease burden. Thus, first priority must be placed on infectious and communicable diseases as well as maternal and childhood illness. In addition, government must take into account the cost effectiveness of various interventions when deciding which interventions to carry out. It is recognised that these changes in the Ministry of Health and Population's approach are a medium to long term objective that necessitate the strengthening of the Planning Unit.

65. In order to realise the benefits of improved budgetary allocation, the management of facilities and programmes must be improved. In particular, cost centre managers need to be made more accountable for the level and quality of outputs delivered and higher-level health facilities should be given greater financial and managerial autonomy.

## **G. AGRICULTURE SECTOR REVIEW**

### **(ix) Background**

66. The agriculture sector is the backbone of the Malawian economy, contributing 37 percent of GDP, 90 percent of foreign exchange earnings and 85 percent of employment. There have been many policy reforms in the sector over past decades, mostly involving liberalisation of previously restrictive production and marketing designed to move the sector away from the previously dualistic structure (estates vs. smallholders).

67. The Ministry of Agriculture and Irrigation has experienced a decline in resource allocation as a proportion of the total Budget. In particular, there have been declines in the recurrent allocation associated with the shift in Government policy towards the social sectors in 1994, partly offset by the development budget. This may be questionable given the importance of agriculture in sustaining the economy and therefore Government revenue. However, despite the limited resources allocated to the Ministry of Agriculture and Irrigation, significant progress has been made in enabling smallholder farmers to reap benefits from liberalisation. This has been achieved through research and extension with a focus on diversification away from high-input crops such as maize and tobacco. For example, according to the National Crop Estimates Survey, smallholder cassava and sweet potato production increased by 423 percent and 222 percent respectively between 1995/1996 and 1999/2000.

68. The Ministry of Agriculture and Irrigation is currently divided into seven programmes, namely: Administration and Support Services; Agricultural Extension Services; Crop Production; Animal Production and Veterinary Services; Agricultural Research and Technical Services; Irrigation; and Land Resources Conservation. As a result of this complex structure, budgeting in the Ministry of Agriculture and Irrigation has become very difficult: the budget document is cumbersome due to there being too many cost centres, programmes and sub-programmes; prioritisation has been undermined resulting in resources being thinly spread across too many sub-programmes; and there are many duplications. In order to overcome these problems, a new structure has been proposed that focuses the Ministry on its core functions (i.e. technical message generation and dissemination) and has only three programmes, namely: Administration, extension and research.

### **(x) Expenditure Trends**

69. Analysis of expenditure trends in the Ministry of Agriculture and Irrigation is complicated by inconsistencies and frequent changes in expenditure classification. However, a number of important findings are relevant. Firstly, wages and salaries account for an increasing majority

of recurrent expenditure, accounting for an average of 67 percent of recurrent expenditure from 1991/92 to 1997/98. Secondly, Ministry headquarters receives the largest proportion of resources, accounting for 42 percent of recurrent expenditure between 1995/96 and 2000/2001. The eight Agriculture Development Divisions (ADDs) have each been receiving less than 10 percent of recurrent expenditure in the same period. Analysis of expenditure by programme reveals that Administration and Support Services has received between 38 and 52 percent of total approved funding between 1998/99 and 1999/2000 due to the huge operational costs it finances, including the bulk of internal travel, office and public utilities. Meanwhile, Extension Services and Research Services have been receiving 10-23 percent and 7-11 percent respectively. In terms of expenditure items, for 2000/2001 the Ministry allocated 51 percent of its approved budget to internal travel, 12 percent to office supplies and expenses and 9 percent to public utilities (excluding Starter Pack).

70. Having examined the expenditure trends, the sector needs to make a headway towards improving both financial planning, management and forecasting on the sectoral level. With salaries and overhead costs dominating the Ministry's allocations the generation and dissemination of technologies has been curtailed as resources for conducting research and extension are not adequate for the desired service delivery. In general, the Ministry needs to allocate resources to priority areas that are well targeted and have some direct impact to production rather than institutional support. In return, the sector should receive adequate resources for the implementation of the various activities under its portfolio. A crucial decision that needs to be made is whether the Ministry should continue maintaining a large workforce which is being paid and at the same time with very little resources to actually do the work under its mandated terms of reference.

71. The Ministry should review its terms of reference as to whether the implementation of national programs, which divert project funds for on-going activities should continue to be its responsibility. In addition, the Ministry should only accept grants that have limited future financial requirements and avoid loans that are donor-driven or have components that demand massive donor supervision missions drawing huge sums of money for supervision staff and leaving very limited resources and even time for implementation of activities. The Malawi Agriculture Sector Investment Programme (MASIP) will pursue all these issues.

#### **(xi) Agricultural Extension Services Programme**

72. The bulk of the Ministry of Agriculture and Irrigation workforce is involved in extension as the Ministry's core function. The Programme is moving towards demand driven provision of extension services following the failure of previous system of extension provision. Future provision will focus where possible on farmers' associations and farmer-to-farmer contact, with elements of cost recovery where possible.

73. In recent years, the Agricultural Services Project (ASP) has been the biggest sponsor of extension activities. During the five period of the ASP, farmer access to extension services increased substantially.

#### **(xii) Crop Production Programme**

74. The programme's mandate is primarily that of addressing the knowledge gap at extension staff level to enhance diffusion of technologies generated by Research. The recent increases in maize, sweet potato and cassava production are partly due to these activities. In future, the

programme will focus its efforts on improving production of grain legumes and neglected cereals such as wheat. However, its efforts continue to be impaired by low levels of funding.

**(xiii) Animal Services and Veterinary Services Programme**

75. The livestock sub-sector is small, contributing only 12 percent to agricultural production, but involves over 50 percent of smallholder families. Current production levels of livestock are far below demand, resulting in substantial importation. The role of the programme is to provide regulation, supervision and veterinary diagnostic services in addition to extension and training. In order to focus on these core functions, a schedule of services to be privatised or contracted out is proposed.

**(xiv) Agricultural Research and Technical Services Programme**

76. In the past, a lack of ownership of the process of technology generation led to a failure in take-up of technologies by farming communities. As a result, in combination with Extension, Research is now being shifted towards a demand-driven approach. As part of this, possible areas for privatisation and contracting-out are being considered. The management of the transition to a more demand driven and private sector approach must be done carefully to avoid creating a vacuum that would damage the agriculture sector. As a result, the approach of the programme is to shift first to cost recovery approaches as an intermediate stage.

77. Government funding of Research and Development has remained below the 1 percent of Agricultural Gross Domestic Product recommended as a minimum for developing countries. In addition, the bulk of the allocation to Research and Development has been spent on overhead costs.

**(xv) Land Resources Conservation Programme**

78. The programme is responsible for the survey and appraisal of land resources and for implementation of soil and water conservation activities within the smallholder sector. These activities have a strong public good element since they involve long term public investment in the environment, particularly soil fertility. However, there is a case for increased community participation and ownership of conservation initiatives. The effectiveness of activities can be increased and the costs cut through promotion of low cost soil fertility technologies, the use of farmer volunteers as extension multipliers and through developing and strengthening farmer associations.

**(xvi) Irrigation Programme**

79. The major function of the Irrigation Programme is to promote sustainable and economically viable irrigated agriculture that benefit as many households as possible, in particular the most vulnerable rural groups. The programme is overseeing a shift from government development and management of irrigation schemes to promotion of small-scale participatory schemes for smallholders and building of private sector capacity. In addition, the programme conducts feasibility studies and research into irrigation technology. The gradual shift to a demand driven and private sector led approach implies cost savings over time. However, it is important to provide adequate support to irrigation schemes in the interim period, and to design a system that will continue to support small holder farmers in the future.