

Chapter 4 - Review of the Development Budget

Ministry of Finance and Economic Planning and National Economic Council

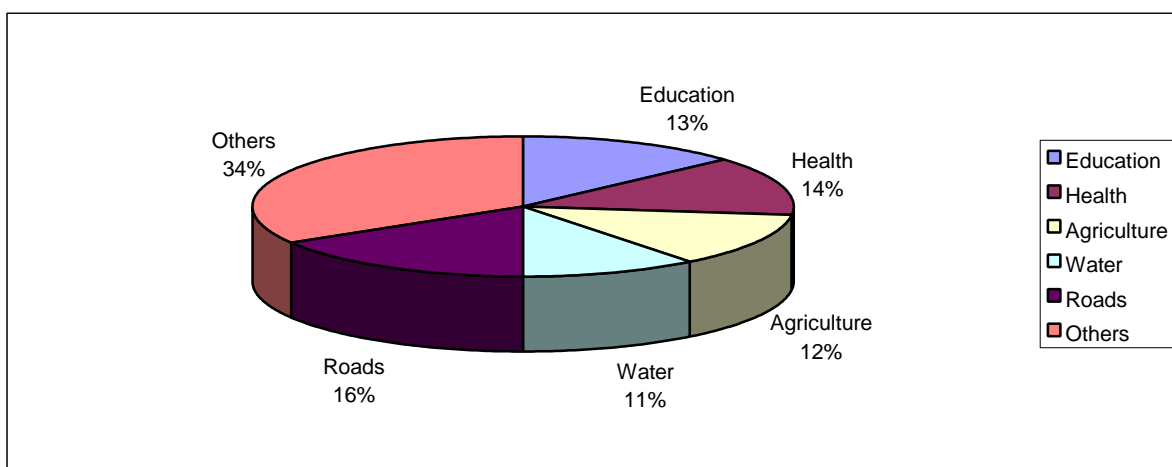
A. AN OVERVIEW OF THE DEVELOPMENT BUDGET

1. The development budget is a summary of investment expenditures, comprising mostly capital and supporting operating costs. It accounts for around 37.3 percent of the overall budget in 1999/00 and this share has had an overall increasing trend over the last five years. The percentage shares in 1995/96, 1996/97, 1997/98, and 1998/99 were 18.9 percent, 19.5 percent, 18.3 percent and 25.3 percent, respectively. In line with other developing countries most of the development budget is donor-funded.

2. To achieve the country's goal of economic growth through poverty reduction, a large proportion of the development account is allocated to health, education, community services, water and sanitation. This social and community welfare sector has been allocated a growing proportion of the development budget; 1.3 percent, 3.76 percent and 4.59 percent of GDP in 1997/98, 1998/99 and 1999/2000, respectively (Table 4.1). In 1999/2000 fiscal year, about 50 percent of the development budget was allocated to agriculture, education, health and water, with education and health accounting for around 27 percent of the Development Expenditure (Figure 4.1).

Fig. 4.1: Development Account Expenditure for 1999/2000

DEVELOPMENT ACCOUNT EXPENDITURE FOR 1999/2000



Source: Financial Statement 1999/2000

Table 4.1: Functional Classification of the Development Budget

Sector	Year (% GDP)				
	1995/96	1996/97	1997/98	1998/99	1999/2000
General Admin.	1.00	1.87	0.46	0.81	1.90
Social & Comm.	3.40	1.35	1.30	3.76	4.59
Economic	1.53	0.76	1.28	2.12	3.71
Unallocable	0.38	0.72	0.10	0.17	0.03
	as	Per cent of	Develop.	Expend.	
General Admin.	15.90	39.76	14.52	11.84	18.57
Social & Comm.	53.95	28.71	41.40	54.76	44.85
Economic.	24.21	16.23	40.83	30.86	36.26
Unallocable	6.00	15.29	3.25	2.53	0.32

3. Economic analysis of the development budget shows that **the share of operations and maintenance (O&M)** in the development budget has experienced a rising trend over the years (Table 4.2) - 21.5 percent, 17.55 percent, 27.55 percent, and 26.09 percent in 1995/96, 1996/97, 1997/98, and 1998/99 fiscal years, respectively.

4. Similarly, the **share of the development budget allocated to buildings has almost tripled between 1996/97 and 1998/99**. This share rose from 13.64 percent in 1996/97 to 34.43 percent in 1998/99. The increase in this share could partly be explained by a heavy concentration in the construction of primary and secondary schools throughout the country, particularly following the introduction of free primary school education in 1994/95.

5. The **share of wages and salaries in the development budget** is relatively small and until last year it was on a declining trend. The decline in wages and salaries over the years is mainly attributed to measures taken by Ministry of Finance of screening out all wages and salaries meant for established staff from the development budget to the normal wage bill on the recurrent budget. However, this share almost doubled between 1997/98 and 1998/99, from 8.50 percent to 16.05 percent - explained by an increase in construction activities, especially primary and secondary schools, which required employment of many casual labourers.

6. On the other hand, the **shares of the development budget allocated to roads, bridges and equipment** have fluctuated sharply in recent years. Between 1995/96 and 1997/98, the share of the Development Budget going to Roads and Bridges increased dramatically from 3.8 percent to 24.0 percent but declined sharply to 5.4 percent in 1999/99.

Table 4.2: Economic Classification of Development Expenditure at Current Prices and also as Share of the Development Budget

	1995/96		1996/97		1997/98		1998/99			
	Actual	%	Actual	%	Actual	%	Estimate	%	Revised	%
Wages and salaries	291.62	17.7	183.76	10.6	136.93	8.5	949.49	17.3	620.29	16.1
Operating and Maintenance	354.13	21.5	303.65	17.6	443.92	27.6	1629.2	29.7	1007.9	26.1
Building	439.75	26.8	235.98	13.6	506.46	31.4	1502.9	27.4	1330.3	34.4
Roads and Bridges	62.05	3.8	305.62	17.7	386.26	24.0	542.11	9.9	207.64	5.4
Equipment	308.93	18.8	469.65	27.2	35.6	2.2	228.05	4.2	104.01	2.7
Services	187.23	11.4	231.15	13.4	102.14	6.3	637.01	11.6	593.85	15.4
Total (current prices)	1643.71		1729.8		1611.3		5488.8		3864	

B. Sources of Funding

7. Tables 4.3 and 4.4 reveal that Malawi largely depends on donor financing to implement its development aspirations. Between 1995/96 and 1998/99 donor contribution to the development budget ranged between 80 and 85 percent. Although there is an increasing trend in the contribution of local resources between 1995/96 and 1999/2000, these efforts are still inadequate and need to be strengthened so that in the long run the major part of the development budget is largely funded locally.

Table 4.3: Government and Donor Contribution to Development Budget (%)

SOURCE/YR	1995/96	1996/97	1997/98	1998/99	1999/2000
DONOR	82.29	82.27	79.75	86.36	77
LOCAL	17.71	17.73	20.25	13.64	23

Source: Budget Documents

8. However, the contribution varies between sectors in different years. In 1995/96, for example, foreign resources financed about 74 percent of the Development Budget in Education, 72 percent of the development budget in Health and 93 percent of the development budget in Agriculture. But in 1998/99, foreign resources accounted for around 92 percent of the development budget in Education, around 94 percent of the Development Budget in Health and around 98 percent of the Development Budget in Agriculture (Table 4.4). Foreign resources are not only an important source of funding to the development budget but also their importance has been growing over the years; in general, foreign resources have increased from 82.29 percent of the Development Budget in 1995/96 to 86.36 percent in 1998/99. However, the estimated share for the most recent fiscal year, 1999/2000, does reflect a significant decline in the donor share of the Development Budget.

Table 4.4: Flow of Foreign Resources and Local Resources in the Development Budget (Aggregate) 1995/96-1999/2000

MINISTRY/SOURCE	1995/96	%	1996/97	%	1997/98	%	1998/99	%	1999/2000 (est.)	%
EDUCATION										
Foreign resources (P1)	132	74	297	93	312	87	442	92	957	83
Local resources (P2)	46	26	24	7	48	13	40	8	203	17
	178	100	321	100	360	100	483	100	1,160	100
HEALTH										
Foreign resources (P1)	143	72	326	88	303	88	1,132	94	1,050	89
Local resources (P2)	57	28	46	12	42	12	67	6	127	11
	200	100	372	100	345	100	1,199	100	1,177	100
AGRICULTURE										
Foreign resources (P1)	178	93	174	93	127	93	1,629	98	909	86
Local resources (P2)	14	7	14	7	9	7	41	2	150	14
	192	100	187	100	136	100	1,670	100	1,059	100

Source: Various Budget Documents

9. The foreign sources of resources are either project loans or grants, or Balance of Payment (BOP) support which can be in the form of loans and grants. Grants contributed 29.7 percent and 27.1 percent to foreign project resources in 1997/98 and 1998/99, respectively, while loans accounted for 70.3 percent and 72.9 percent of the development budget's foreign financing in 1997/98 and 1998/99, respectively. The high proportion of loans is of concern for

Malawi as it implies an increase in debt burden and eventual pressure on the budget when these loans mature. Malawi's external debt in nominal terms stood at US\$2.6 billion or 870% of GDP at the end of 1999.

10. The heavy reliance on foreign resources to finance the Development Budget raises a number of concerns. The concerns include uneven commitments of foreign resources, uncertainty of disbursements and the budgetary implications of debt servicing. These issues are discussed in Section C.

11. The concerns outlined in the preceding paragraph call for the need to increase the share of domestic sources of revenue to finance the development budget.

C. IMPLEMENTATION PROBLEMS

12. Government's capacity to implement the Development Budget depends on the availability of resources, both financial and human. One way to examine this capacity is to look at the Government's actual spending to amount budgeted ratio and also its ability to fund the budget. Table 4.5 gives the variation between estimates (budgeted expenditure) and actual funding for the three sectors of Education, Health and Agriculture. The picture that comes out shows that, in general, actual development expenditure has been less than estimated development expenditure and actual funding is less than budget estimate.

13. A number of factors explain this deviation between the estimated and the actual expenditure of the development budget. These factors are discussed below under two sub-headings: Capacity of Government of Malawi and Capacity of Donors.

(i) Capacity of the Government of Malawi

14. Most projects in the development budget require Government's financial contribution. If the Government cannot raise enough resources for its contribution to the development budget, implementation is hampered. An example is the implementation of World Bank funded projects. Data available indicates that Malawi has been having difficulties meeting counterpart funding for some of the World Bank funded projects. As of September 30, 1999, Government counterpart funding arrears stood at K6.2 million (Annex: Table 4.6).

15. Lack of or delays in counterpart fund contributions is a result of a number of factors. These include the devaluation of the Kwacha; limited Government revenues; the cash budget system being implemented by Malawi; expenditure ceilings on the Government budget; and incorrect estimation of implementation progress, costs and disbursements; inaccurately costed and incomplete Annual Work Programs (AWPs); untimely release of funds from the Treasury; inadequate accounting for funds received by sector ministries¹. and insufficient implementation and enforcement of expenditure prioritisation at the sector ministry level.

16. Thus, to solve this problem, line ministries need to submit to the Ministry of Finance and Economic Planning (MoFEP) the exact amount of arrears; project units to submit realistically costed AWPs to the MoFEP and MoFEP to fully fund them; ensure expenditure prioritisation and implementation of the Medium-Term Expenditure Framework (MTEF); and also, develop capacity to negotiate with donors on various conditions.

¹ Delayed submissions of monthly expenditures returns and use of funds for other activities

17. In utilising donor resources, the Government uses three types of disbursement procedures: direct payments, special accounts and reimbursement. In the case of direct payments, donors disburse funds directly to the suppliers of goods and services. In the case of special accounts, donors require the implementing agency to open a special account for which donor funds are disbursed for utilisation. Reimbursement procedure requires the Government to make an up front expenditure and get reimbursed by the donor after verification that the expenditure was according to project agreement. The reimbursement procedure causes the largest fluctuations in project funding.

18. One strategy adopted for reducing the deficit and maintaining it to a manageable level was the introduction of the cash budget system. The system ties public expenditure to mobilisation of revenue. Line ministries receive cash on monthly basis to cover recurrent and investment expenditures according to their budget cash flow. Thus, the cash budget system was introduced to ensure that expenditure ceilings are adhered to and consequently reduce budget deficits.

19. However, the amount actually transferred is not only determined by votes according to the budget but also according to the extent to which revenues have actually been collected in line with budget projections. More often than not, the amount disbursed to ministries on a monthly basis is less than the expected budget figure as illustrated by table 4.5. When collections fall short of the budget it negatively affects total budget implementation. This is apparently one major reason for shortfall in domestic resources on time for smooth implementation of the development budget. This compliments the irregular flow of donor resources as mentioned earlier on.

Table 4.5 : Estimate and Funding for Part 2

MINISTRY	1997/98			1998/99		
	Budgeted	Funding	Variation	Budgeted	Funding	Variation
AGRICULTURE	26,042,597	26,042,597	nil	40,746,715	38,598,721	2,147,994
EDUCATION	87,139,384	83,322,917	3,816,467	40,355,583	39,428,245	927,338
HEALTH	50,439,846	48,564,846	1,875,000	67,482,590	55,224,019	12,258,571
WATER	55,570,938	52,589,712	2,981,226	267,394,498	218,272,286	49,122,212

Source: Various Budget Documents

(ii) Donor capacity

20. A number of problems have been associated with the provision of financial assistance to Malawi. For instance, financial assistance has been irregular and the split between grants and loans have varied over the years as discussed in Section 4.2. In addition, the assistance has often been uncertain as disbursements have been tied to multiple and varied conditions and the commitments and interpretation of conditions have changed over time. Disbursement patterns are generally lumpy and often front-loaded.

21. Failure to meet donor conditions has been another problem. This has resulted in disbursement delays and hence having negative repercussions on the economy². The cost of

² One example is the delayed disbursement of the \$30 million second tranche of the Second Fiscal Restructuring and Deregulation Project (FRDP II) in 1999. This tranche was due in August 1999 but it could not be released till

these delays is substantial, for instance, it has been estimated that the cost of delays in foreign aid inflows over the three-year period 1996 to 1998 to Malawi was in excess of US \$33million or over US \$11 million per annum (Marshall 1999).

22. Other problems have related to administrative procedures of donors, excessive number of project missions detracting from Government and the lack of long-term commitment of funds by donors, contrary to the principles of the Medium Term Expenditure Framework.

23. In order to improve foreign assistance flows to Malawi, it is recommended that there be longer term commitments by donors to match the needs and principles of MTEF; Government negotiates for fewer conditionalities and ensure that the MoF involves key stakeholders in loan negotiations; and that donors consider introducing less lumpy disbursements that could be addressed by equal sliced tranches and regular flow through out the year. Crucially, it is important that donors design projects which are consistent with overall sector priorities and that they include recurrent cost provisions in their projects. It is also recommended that there be capacity building within the Debt and Aid Management Department of the Ministry of Finance (MoF) to enable it to track aid inflows and forecasts.

D. PROJECTS AND PROGRAMMES OUTSIDE THE DEVELOPMENT BUDGET

24. The existing development budget fails to cover a large number of projects implemented by Government and by non-Governmental organisations (NGOs). Table 4.9 (annex) is a partial attempt to capture these projects. The figures for NGOs in the table have been compiled following a survey on operations of various NGOs in Malawi. The projects captured are largely in the health, education, agriculture and community development sectors (Table 4.6). It must be stressed that these figures are only estimates as it is almost impossible to capture all expenditures by NGOs at present. The figures in the table are dominated by Action Aid, which accounted for 84 percent of the reported NGO expenditure in 1995/96, falling to 16 percent in 1998/99 before rising again to 28 percent in the projections for 1999/2000 (Table 4.9).

25. The total estimate of on-going projects not in the development budget is K1,276 million, approximately 15 per cent of the 1999/2000 Government development budget. K698.9 million worth of projects is managed by Government and K578.1 million by NGOs. However, it should be noted that these are underestimates, as many projects have not been captured in this analysis.

Table 4.6: Sectoral Estimate of NGO-Funded Projects at 1995/96 prices

	1995/6	1996/7	1997/8	1998/9	1999/2000
Community Development	112,819,154	147,316,960	158,041,696	173,291,707	82,682,476
Education	105,000,000	28,895,384	72,862,514	74,743,422	36,740,861
Agriculture	55,000,000	33,023,296	58,061,336	64,600,999	31,774,678
Health	60,000,000	58,616,350	68,181,379	82,396,440	76,016,984
TOTAL	332,819,154	267,851,989	357,146,925	395,032,569	227,214,999

26. According to available data, NGO funded Community Development projects a 50 percent increase in real terms between 1995/6 and 1998/1999 but an estimated 43 percent decline in real terms from 1998/99 to 1999/2000. In the health sector, there has been a 175 percent

January 2000 because the Malawi Government could not meet some of the conditions attached to the credit according to agreed time plan.

increase in nominal terms from 1995/96 to 1998/99, which translates to a 37 percent increase in real terms. The projected 1999/2000 figure of MK193 million represents an 8 percent decrease from 1998/99. In the education and agriculture sectors, there has been no clear trend in NGO expenditure.

27. In order to gain control over public expenditure, it is essential for several reasons that at least Government managed projects be included in the development budget. Firstly, it will improve transparency on how project funds are handled. Secondly, it will also assist the Ministry of Finance and Economic Planning in monitoring these projects and their recurrent funding requirements. Thirdly, it will be easier for Government and donors to assess the capacity of ministries and departments to implement these projects.

28. As for projects managed by NGOs, it is important that a mechanism be identified which enables Government to have clear information on what projects are being implemented. This will help reduce duplication of efforts, save scarce resources and contribute to the development of a Sector Wide Approach (SWAP) (see chapter 3).

E. PRIORITIZING THE DEVELOPMENT BUDGET

(i) Priority Setting at National Level

29. Ideally, the development budget should reflect national goals and objectives since it is a tool for implementing the various strategies for achieving government objectives and goals. Thus, any attempt to prioritise development expenditures should be cognizant of national goals and objectives. In the case of Malawi, the overall goal is to alleviate the currently widespread poverty as outlined in the Vision 2020 policy document. The process of prioritising expenditures is an important exercise since it aims at directing the limited available resources to areas that will yield the greatest returns and have the greatest impact on reducing poverty. In this regard, there is need to channel those resources into programmes and projects that will enable the economy realize the set goals and objectives.

30. Government's medium term development objective is to achieve sustainable economic growth and improve access to the basic social services (Policy Framework Paper, 1998/2000). The sustainable economic growth is to be achieved by adopting appropriate monetary, fiscal and exchange rate policies, which would lead to low inflation, and stability of local currency, increase agricultural productivity and investment in infrastructure. Improved access to social services will be attained by improving quality, and access to primary education, and basic health services within the existing fiscal constraints.

31. The sectors of health and population, education and agriculture are thus selected as the priority sectors for government, in order to achieve its development objectives. This implies that, in general, most interventions targeting these three sectors are a priority relative to development projects in all the other sectors of the economy, hence, will be supported. Additional merit will also be accorded to projects in these three sectors that support directly the reduction of poverty, such as interventions that will reduce illiteracy, improve nutrition and sanitation, or improve smallholder farmer's productivity etc. In practice this picture is observed as seen from the development budget allocation. The three priority sectors of agriculture, health and population and education when summed up receive the biggest share of available resources in the overall development budget.

(iii) Priority Setting at the Sector level

32. The prioritisation process at sector level was analysed from several perspectives in order to get a comprehensive picture, namely; intra-sectoral allocation, the focus on poverty; and sustainability of the project activities.

F. INTRA-SECTORAL PRIORITISATION

33. The intra-sectoral prioritisation tries to examine the relationship between the sectors' main objectives and strategies and the projects being implemented. In line with the various sector objectives and strategies, the projects in the agriculture, health and education sectors have been summarised from the development budget documents and classified into high and low priority areas. However, the development budget in its present format does not cover all projects being implemented as discussed in section D. In this analysis, the high priority projects are those that contribute highly to the achievement of the sectors' main objectives and national goals. Low priority projects are those that have lower or indirect contribution to the achievement of the other sector objectives and goals. In addition, high priority projects need not necessarily take up the bulk of the resources in the sector, whereas if a large part of available resources are allocated to the lower priority projects, this may reflect a problem of priority setting in the sector.

34. In the agriculture sector, the main objectives are to improve food self-sufficiency and the nutritional status of the population, raising farm incomes and to expand and diversify the agricultural and livestock product exports. The main strategies that have been put in place to achieve these objectives include: increasing small-holder agriculture productivity, improving soil fertility, liberalisation of agriculture marketing and pricing policies and prevention and control of malnutrition and nutritionally related diseases³.

35. An analysis of the projects being implemented in this sector shows that the high priority projects get a significant proportion of the sector's development budget (65 per cent) whilst the lower priority projects have a relatively smaller proportion of the resources (35 per cent) (Tables 4.12a and 4.12b). This outcome generally indicates a greater focus on implementing projects that directly contribute to the achievement of the sector's high priorities objectives, implying that most projects tally with the sector strategies. However, other strategies are not adequately supported by appropriate interventions in the form of projects such as the prevention and control of malnutrition and nutritionally related diseases.

Table 4.12a: High Priority Projects in the Agriculture Sector

High Priority Projects	Total Estimated Cost (TEC)	Of which Government of Malawi Contribution
Starter Pack Scheme	602,564,465	19,440,000
Agriculture Services Project		
Rural Income Enhancement Project	83,047,067	59,171,260
Marketing Advisory Services	27,898,349	6,233,627
Maize Productivity Task Force	50,658,513	0
Crop Estimate Methodology	14,463,130	0
Food Security Monitoring	11,245,636	0
Price Information System	6,776,162	0
Production and Marketing	62,825,056	0

³ Malawi Government, *Interim Poverty Reduction and Growth Strategy Paper*, May 2000.

Dev. Agric. Marketing Information system		
Burley/Maize Development	40,850,000	0
Smallholder Food Security	1,478,741	531,883
Support to Crop Diversification	27,109,719	6,718,447
Food Security	35,600,000	0
Small and Micro-Scale Irrigation	107,296,660	9,700,001
Agricultural Farm Input	302,392,105	41,006,906
Maize Productivity Marketing	162,533,077	0
Horticultural and Food Crops Development	17,752,110	3,560,789
Proscarp	89,250,924	9,297,710
Dam and Dambo Development Project	566,897,432	1,236,300
Construction of Irrigation	46,932,044	2,688,135
Smallholder Flood Plains Development	75,897,111	75,897,111
	456,354,263	42,669,999
South Africa Foot and Mouth Disease Control		
National Livestock Development	9,280,589	985,000
LADD Disease Control	136,065,349	13,953,761
Basic Animal Health Services	6,102,500	610,250
Small Stock Development Project	33,312,028	13,809,883
Group Maize Development	34,423,285	13,412,997
Farm Gate Pricing Exercise	12,274,272	0
Agricultural Productivity Investment	12,731,975	0
Price and Market Monitoring	55,500,000	0
Bwanje Valley Irrigation Project	14,057,160	0
<i>Total</i>	11,272,000	3,752,000
	3,114,841,822	324,676,059

36. The education sector goals are to increase access, quality, relevance and efficiency of education to the children and youth in Malawi. The main strategies being implemented to achieve this goal are: provision of the necessary infrastructure, equipment, teaching and learning materials; and the provision of qualified teachers at the primary level.

37. The analysis of this sector reveals that the high priority projects utilise less than half of the resources available in the development budget whilst lower priority projects take up the remaining share. In addition, some priority strategies such as those on teacher development and provision of teaching and learning materials do not seem to be well supported with projects in this sector's development budget (Tables 4.13a and 4.13b). This analysis, however, may not be very revealing as noted in Section D that several donors fund primary education projects outside the development budget.

Table 4.12b: Low Priority Projects in Agriculture Sector

Low Priority Projects	TEC	Of which Government of Malawi Contribution
MALSPI	288,862,159	41,034,061
Planning and Policy Review	48,380,100	0
Strengthening Food Nutrition Unit	48,307	0
Population and Nutrition	12,771,444	2,438,119
Support to Privatization of Crops	2,851,125	0
ASIP	589,446,570	0
Natural Resources College	25,678,309	1,794,698
Agriculture Services Project		
Procurement		
Transport Management	25,862,858	1,736,129
Financial Planning and Management	6,649,006	3,481,385
Planning Development Institutional Strengthening	34,849,827	5,749,827

Monitoring and Evaluation System	53,275,982	5,757,535
Computer Training	4,392,805	0
Support to crop Diversification	35,600,000	0
National Early Warning Unit	6,802,000	0
Agricultural Policy Training	105,821,858	44,798,414
	37,834,735	5,175,811
Agriculture Advisory Unit		
Ministry of Agriculture Reform	99,917,959	0
Technical Assistance to MOA	2,312,500	0
Technical Assistance to STABEX Operations	1,517,000	0
RTTCP	18,500,000	0
Agriculture Cadastar	37,000,000	0
MICAH	2,193,240	0
Malawi Agro-Forestry Project	10,203,606	0
Experimental Solar Pump for Irrigation	4,025,000	0
Water Resources Study	6,828,000	848,000
Sprinkler Resource Study	47,640,000	36,240,000
Land Resource and Conservation	5,852,169	4,531,019
Mwanza RDP	261,523,090	3,326,750
Balaka RDP	50,732,450	10,433,000
<i>Total</i>	115,104,068	16,789,518
	1,679,476,866	144,836,334

38. In the health and population sector, the goal is to raise the level of health status of all Malawians by reducing the incidence of illness and occurrence of death. This goal will be achieved through the following medium term strategies: increasing the provision and improving the management of drugs and medical supplies; promotion of clean water and sanitation, expanded programme on immunisation, family planning; and controlling the spread of malaria and HIV/AIDS.

Table 4.13a: High Priority Projects in the Education Sector

High Priority Projects	TEC	Of which GoM Contribution
Primary Education Project	92,805,200	4,210,529
ADF Education iii Project	88,423,392	0
Primary Education Project (TDO)	92,792,768	7,990,357
Primary Education Project N.School	388,769,477	20,513,458
ADF Education iii 10 Primary Schools	310,456,478	70,673,953
ADF Education iii 2 DEO Offices	176,673,091	4,555,164
Primary Education Project Supplies Unit	65,560,425	7,110,223
Gable	1,049,972	1,049,972
<i>TOTAL</i>	1,216,620,804	116,103,656

4.13b: Low Priority Projects in the Education Sector

Low Priority Projects	TEC	Of which Government of Malawi Contribution
Secondary Education Staff Development	69,813,559	0
Secondary Education: Construction of Day Secondary Schools	1,796,788,205	88,455,638
ADF Education iii 3 Day Sec. School	437,174,025	48,415,637
Secondary Education Project Supplies Unit	713,495,251	33,556,731
Secondary Education Project EDMU/ADM	2,443,874	2,443,874
IDA Education Sector (Rehabilitation)	2,790,870	2,790,870
Kamuzu College of Nursing	12,000,000	12,000,000
Medical College	4,000,000	4,000,000
Mzuzu University	70,000,000	70,000,000
Construction of Building (NC of Sport)	19,800,000	19,800,000

<i>TOTAL</i>	3,128,305,784	281,462,750
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39. An analysis of this sector's development budget shows that resources are shared almost equally between the high priority and low priority areas (Table 4.14). On the high priority projects, infrastructure provision takes up a large share (65 per cent) of the allocated resources, leaving only a small proportion to cater for the other priority areas. This raises questions on the quality of services offered in the other remaining priority areas highlighted in the sector's objectives such as immunisation programmes, family planning, controlling the spread of malaria and provision of clean water and sanitation.

Table 4.14a: High Priority Projects in the Health sector

High Priority Projects	TEC	Of which Government of Malawi Contribution
PHN Drugs	105,507,585	0
PHN PHC	47,740,600	1,910,600
ADB Support NACP	61,000,000	0
EU HIV/AIDS	74,550,000	0
EU Blood Safety	241,000,000	0
PHN Nutrition	41,333,810	1,258,500
PHN IEC	25,243,000	0
EU Safe Motherhood	36,000,000	0
Mzuzu Central Hospital	184,338,097	0
ADB -Salima District Hospital	7,617,968	1,000,000
EU -Thyolo District Hospital	554,175,000	0
OPEC Nkhonkhotakota District Hospital	418,710,600	103,890,600
<i>Total</i>	1,797,216,660	108,059,700

Table 4.14b: Low Priority Projects in the Health Sector

Low Priority Projects	TEC	Of which Government Contribution
PHN project Management (PIN)	39,340,074	0
Staff Project Management	1,828,284	0
Dutch Support (Project Management)	146,891,250	0
Staff Development	6,214,261	0
ADB Health Study	20,018,229	8,184,038
EU Physical Assets Management	306,493,750	0
PHN Decentralization	135,000	0
PHN Nutrition Bunda	2,702,440	113,950
PHN Nutrition NEC	9,007,250	0
PHN Nutrition MOA	1,464,000	0
ADB Blantyre School of Nursing	53,553,208	5,668,402
ADB Medical School Project	494,067,027	445,067,027
PHN (Hospital Efficiency)	30,574,000	0
PHN (Govt. Works)	242,368,097	0
PHN MASAF –PHN collaboration	127,140,615	0
Dutch Supp. Programme (Strengthening health delivery system)	161,977,500	0
Nursing and Midwives Council	3,758,985	3,758,985
PHN Urban Health Centres	18,200,000	18,920,000
New Dental Unit (LCH)	5,154,000	5,154,000
<i>Total</i>	1,670,887,970	486,146,402

(i) Poverty focus

40. The other criteria used in analysis of the prioritisation of the development budgets for the three sectors relate to their focus on poverty issues. The focus on poverty stands out

specifically because it is the overall policy objective of government. Hence, any development project that promotes services delivery to the poor, directly contributes to the reduction of poverty in the country.

41. In the health sector, it was noted that most of the resources allocated to the priority areas go to infrastructure provision. This has implications on the quality of services offered in other priority areas that are directly beneficial to the poor such as provision of drugs and medical supplies, immunisation programmes, family planning, controlling the spreads of HIV/AIDS and malaria; and promotion of clean water and sanitation. In the education sector, most of the allocations in the high priority projects go towards infrastructure provision, as is the case in health. Questions could also be raised as to the adequacy of the resources directed towards other remaining priority projects that directly benefit the poor such as provision of teaching and learning materials, and teacher development programmes. In the agriculture sector, there is a greater and direct focus on implementation of projects that benefit the poor such as the starter pack scheme, improvement of productivity and food security. However, the priority strategy on control and prevention of malnutrition and nutritionally related diseases doesn't seem to be well supported with appropriate interventions. This is despite that it has a direct impact on the welfare of the poor.

(ii) Sustainability

42. In analysing the prioritisation of the development budget the issue of sustainability of project activities both in the medium term and beyond the project implementation period were also examined. This is to acknowledge the fact that most investments tend to have recurrent cost implications beyond the actual project implementation period and these need to be taken into account when selecting priority projects in the development budget.

43. The analysis of the education sector revealed that quite a number of projects recorded in the development budget are fully funded using government resources. This is quite a positive development since it depicts Government commitment to take charge of the development process and financing it. Another observation in most of the education sector projects is that although there is a high component of donor financing, there is also an effort to provide counterpart funding by the government. (Table 4.13)

44. In the health sector, however, the picture is quite different from that in education. Only a limited number of projects in the development budget are fully financed using Government resources. In addition, even the provision for Government counterpart funding in the donor-financed projects is low (Table 4.14). In the agriculture sector, there is also a heavy leaning towards more donors financing the development budget. Total financing of projects using domestic resources in total is very minimal in this sector, whereas counterpart funding for donor-funded projects is quite considerable. (Table 4.12)

45. Taking into account the aspect of sustainability in the prioritisation process, the picture portrayed in the three priority sectors can be summarised as follows: -

Financing of projects in the development budget using local resources in totality is a welcome development as it displays government commitment to the implementation of those particular projects. Therefore, sustainability of these projects should be greater since the likelihood of including their recurrent costs in the budget is very high. Hence, projects falling in this category rank highly in the prioritisation process. Implications from this are that projects in

the education sector are more likely to be more sustainable, followed by those in agriculture. The projects in the health sector are likely to be the least sustainable.

Secondly, projects that tend to have some counterpart financing from government have good chances of being sustainable beyond their project life when compared to those projects that are completely financed using donor resources. This is because there is already some commitment by government on these projects. Hence, it may be easy to absorb the subsequent recurrent costs. On this particular aspect, projects in the education sector are more likely to be sustainable in comparison to those in the agriculture and health sectors.

Thirdly, the projects that are fully financed from donor resources and have considerable recurrent cost implications may have their sustainability compromised, particularly when there is little government commitment to provide for them in the recurrent budget. This is so because it implies adding completely new expenditure items into the recurrent budget and this is likely to be problematic considering the tight budget constraint that Government faces most of the time. On this indicator, the problems of sustainability are likely to be greatest in the health sector followed by agriculture and the least in the education sector.

Further analysis of the three sectors reveals that a significant proportion of the projects in the health and education sectors relate to infrastructure provision. The infrastructure projects in these sectors tend to have significant recurrent cost implications. The picture in the agriculture sector, however, is different. With regard to this aspect, agriculture projects have a greater chance of being sustainable in comparison to those in health and education.

(ii) Towards a Re-Prioritisation of the Development Budget

46. The analysis of the prioritisation of the development budget reveals a number of issues that need to be revisited. These include the following:

The way the development budget is handled at present leaves a lot to be desired. There are many projects that are being implemented outside of the recorded Government development budget. By analysing the development budget that is recorded in this manner, one gets a partial and sometimes false picture of the situation on the ground. Thus, the recommendations made on the basis of this kind of analysis of the development budget may be questionable.

The development budget contains a considerable proportion of expenditures that are operational in nature whereas the recurrent budget also comprises of some capital items. This situation raises some issues on how we should analyse both the development and recurrent budgets. In addition, these operating expenses in the development budget have tended to grow over time, covering items like personal emoluments and goods and services.

Capacity to implement the development budget is also a critical area that needs to be examined. The analysis of the three major sectors highlights the considerable number of project implementation units handling the various donor-supported projects. This situation arises from the differing implementation arrangements pursued by donors. Whilst this may be convenient from the donor's point of view, it is cumbersome on the part of Government. This calls for the need to synchronise these processes so that there is minimal duplication of effort.

The issue of prioritising the development budget seems to be quite complicated in practice. This highlights the need to devise some basic guidelines that could be applicable both within and across sectors for ease of analysis.

The proportion of the development budget that should go to high and low priority areas is not very clear and seems to be set arbitrarily with no particular targets. This is evidenced by the wide differences in the proportions of funding allocated to high and low priority projects across the three sectors. This needs to be clearly set in line with sector priorities, objectives and set targets so that the development budget clearly reflects priorities.

47. In light of the above analysis, it is clear that deliberate efforts should be made to improve in the following areas:

There is need to integrate the development and recurrent budgets. This is to enable meaning full analysis to be carried out on the overall public expenditures. This process will also remove the problems in the treatment of operating expenditures and capital investments in both the development and recurrent budgets.

There should be one machinery for implementing the whole development budget. Thus, there is need to put in place a deliberate strategy to integrate all extra budgetary contributions to the Government's development budget books by donors. This will enable Government to keep track of all expenditures incurred in the name of the development of the country.

Realising that the primary objective of increased investment in social services is to improve the quality of life of the majority of the poor, it is necessary to ensure that most of this investment goes towards the implementation of projects that directly impact on poverty and not the lower priority projects. This is especially so in light of the growing proportions of the operating costs of implementing projects over time.

When prioritising the development budget the sectors should be looked at in totality, so that no critical areas are inadvertently omitted. This is important because in some instances, sectors are not necessarily synonymous with sector ministries and overlaps may occur. In such cases all the concerned institutions need to be involved appropriately. For example, issues of water and sanitation, nutrition, irrigation, adult education, etc. tend to be sidelined as they are not in the main-stream sectors of health, agriculture and education.

Priority areas should be adequately funded to ensure their smooth implementation whereas the low priority areas should either be eliminated, where necessary, or have their funding reduced accordingly.

G. INSTITUTIONAL FRAMEWORK

48. Intra-Government coordination: The Ministry of Finance, in close consultation with implementing agencies, is responsible for preparing the development budget and all activities in monitoring, funding and evaluation of projects. This arrangement, however, does not fully involve key players like the National Economic Council (NEC), the Ministry of Foreign Affairs and International Co-operation, the Department of Local Government and District Administration, the Office of the President and Cabinet (OPC) and others.

49. NEC is responsible for preparing the development policy of the Government and hence, its participation ensures that the projects being designed and implemented are consistent with national goals. The Department of Local Government and District Administration should be involved in the preparation and implementation of the development budget so that it adequately assists the district assemblies in the formulation and implementation of their programmes. Given that around 80 percent of development budget is currently financed by donors, it is important that the Department of International Cooperation of the Ministry of Foreign Affairs and International Cooperation participates in project financing arrangements so that foreign missions abroad can be in touch with foreign sources of financing.

H. RECURRENT COST IMPLICATIONS OF THE DEVELOPMENT BUDGET: R COEFFICIENTS

50. In Malawi development projects were until 1998/99 fiscal year grouped under the Public Sector Investment Programme (PSIP). The PSIP contained a brief discussion of the Government's overall development objectives, a description of sectoral strategies and a set of on-going and planned development projects. Information on the development projects include project descriptions, locations, total costs and the annual phasing of the projects, the breakdown of foreign and counterpart funds required and their financing (if identified).

51. The PSIP consisted largely of donor-financed projects. In some cases, the projects were identified, designed, appraised and implemented by donors themselves regardless of whether such projects were a national priority. There was also a tendency among several donors, during the period under review, to fund individual projects whose consistency with their sectoral priorities was often ignored. Consequently, the recurrent costs of the existing capital investments were grossly under-funded, and the recurrent cost implications of the PSIP were not taken into account.

52. In order to determine the extent of the recurrent cost implication of the development budget in the future, as well as to evaluate the adequacy of recurrent expenditures historically, a set of ideal recurrent cost coefficients is important. The r-coefficient, or the ratio of annual net recurrent expenditure requirements of the completed investment expenditure to the value of the total investment expenditure, is a useful concept in this regard. While the project profiles can provide estimates of the recurrent cost implications of the development projects, the r-coefficient, on the other hand, can be calculated based on a rough average estimate, or through an econometric estimation.

53. In this review, the estimation of the r-coefficient is based on the sample of data on recurrent and capital expenditures of three major projects (completed projects – see attached data) in each of the three main sectors of Health, Education and Agriculture. In estimating the r-coefficients, the focus is on the relationship between recurrent expenditure in a five-year period (1994 to 1999) of project implementation⁴ and the sum of development expenditure in constant prices but undiscounted. The expenditure data was fragmented into personal emoluments, operating and maintenance, and capital formation. The findings are complemented by a cross-country analysis of typical r-coefficients in various developing countries although the findings would tend to underestimate ideal levels. It is assumed that recurrent costs of projects are passed on to the recurrent budget immediately after such projects are completed.

⁴ Since none of our sample projects reached normal operation during this review exercise

I. ESTIMATE BASED ON RECURRENT AND CAPITAL EXPENDITURES

54. An estimate based on a ratio of operation and maintenance to the total investment cost of sample projects for the entire period covered by the above stated data gives us the rough estimation of the r-coefficients. The calculation did not take into account personal emoluments because by doing so we are likely to be confronted with the problem of allocating expenditures that occurred once during the implementation period and never again. Care must be exercised when interpreting the findings considering the heterogeneity of the functions carried out in the sample projects although the ratio's margin of uncertainty does not appear so great as to undermine completely its usefulness. An attempt was not made to disaggregate the results but that notwithstanding, it is also suggested that the interpretation of the results take into account the fact that the effect of development expenditures could be quite different in different projects.

55. The findings of are presented below (Table 4.15). The results are then compared by those obtained by P. Heller⁵.

Table 4.15 : PER R-Coefficients

Sector	PER r-coefficient	Heller r-coefficient
Agriculture	0.82	0.08-0.43
Education	0.13	0.08-0.72
Health	0.28	0.11-0.71

56. The above results show, *ceteris paribus*, that the relationship between recurrent expenditure and the sum of development expenditures for the three sectors under consideration indicate that the impact on the recurrent expenditures of an increase in development expenditure is MK0.41 on average for every MK1.00 invested. This clearly indicates that capital investment in the three sectors had reasonable recurrent cost implications. An analysis of individual sectors shows that for every MK1.00 invested in our sample projects in Education, Health and Agriculture, the implication on recurrent budget is MK0.13, MK0.28 and MK0.82, respectively. In general, these results make sense (although we are not very sure why the impact in Agriculture is so large).

57. What these results demonstrate is the importance of further disaggregating of data. By using an estimate for the impact on total recurrent spending of an increase in development expenditures could significantly bias the recurrent expenditure estimates in the individual sectors. This does not imply that the computed r-coefficients are not reliable although they may underestimate requirements in an ideal sense.

J. TOWARDS INTEGRATING THE RECURRENT AND DEVELOPMENT BUDGETS

58. It is clear from the results that the recurrent cost implications on investment projects lack sufficient recurrent expenditure requirements to operate and sustain the existing capital investments. The problem partly surfaced as a result of the separation of the planning and finance functions that was there before 1998/1999 fiscal year. Planners were primarily interested in generating, evaluating, and advocating new projects, and were usually not

⁵ P.S. Heller, "The Underfinancing of Recurrent Development Costs", Finance and Development, March 1979.

concerned about the adequacy of financial resources to cover such projects in future nor in assessing the recurrent cost implications of such endeavours. This, however, does not suggest that consideration of future operating and maintenance costs were not included in their analysis but that planners put more emphasis on on-going and new projects without due consideration on what will be the funding arrangement once the project is phased out.

59. For projection purposes, it will be necessary to use higher figures than those obtained from historical data because Malawi expects a shift of development expenditure towards the social sectors if the Highly Indebted Poor Country (HIPC) Initiative Malawi is being considered for goes through. Also, it will be necessary to institute a wide range of measures during the implementation of Vision 2020 and indeed when implementing the Medium-Term Expenditure Review (MTEF) to reduce wastage and inefficiency in public expenditure.

60. Similarly, the bias in favour of capital investments as evidenced by the findings in this chapter, and indeed the bias towards new investments against recurrent expenditures need to be analysed critically. This calls for an integrated analysis of capital against recurrent expenditures within major sectoral programs. Admittedly, the bias has been driven in significant part by donor investment programs. Where projects had full financing commitment from donors, Government rushed to implement such projects even if they did not accord with the government's priorities, and even if existing and new investments could not be supported by the necessary recurrent outlays.

61. At present, planning and budgeting systems separate the recurrent and development budgets. Thus, resource allocation between the two budgets hardly shows any relationship. Consequently, recurrent cost implications of the development budget are not taken into account. One of the activities to be undertaken in the implementation of the MTEF, is the integration of the two budgets. So far, very little has been done by both the Government and donors to achieve this objective. As mentioned earlier on, donors through specific projects support a bulk of development expenditure. To this effect, unless donors move away from project financing towards supporting the budget in different sectors, integration will remain impossible. Likewise, the Government should also start planning and budgeting for a sector as opposed to specific projects for a particular ministry. Thus, Government's commitment toward implementing Sector Investment Programs (SIPs) and Sector-Wide Approaches (SWAPs), which already exist in sectors of Agriculture, Health and Education, will assist greatly.